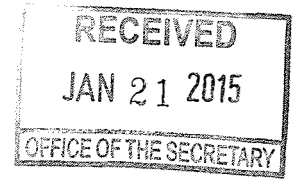


UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING  
File No. 3-15873

In the Matter of

Thomas R. Delaney II and Charles  
W. Yancey

Respondents.

**RESPONDENT CHARLES W. YANCEY'S RESPONSE TO DIVISION OF  
ENFORCEMENT'S POST HEARING PROPOSED FINDINGS OF FACT**

Respondent Charles W. Yancey (“Yancey”), by and through counsel, submits this Response to the Division of Enforcement’s (the “Division”) Post Hearing Proposed Findings of Fact. Pursuant to the Court’s Post-hearing order (Thomas R. Delaney II, Admin. Proc. Rulings Release No. 2011, 2014 SEC LEXIS 4305 (Nov. 13, 2014)), this submission indicates which of the Division’s Proposed Findings of Fact Yancey does not dispute. Where Yancey disputes the Division’s Proposed Finding of Fact, this submission provides the reason for the dispute and a counterstatement accompanied by quotations of the key language from the evidentiary record that supports the objection and counterstatement. Also, for the Court’s convenience, the table below reflects the numbered Findings of Fact that Yancey disputes.

***No Dispute***

1, 7-12, 15-16, 19-20, 24, 28-30, 32-37, 39, 49-51, 53, 66-69, 73, 78-79, 88, 96-97, 101-103, 105, 107, 110, 113, 118, 122, 129, 133, 140, 142, 144, 146, 151-153, 156-158, 160-161, 167-168, 171-173, 177, 179-181, 183, 188-189, 191, 197-198, 202, 204, 206, 208-209, 215-216, 218-220, 225, 233, 238, 246, 248, 253-255, 257-258, 272, 274, 279, 295, 297, 317-318, 321

***Dispute***

2-5, 13-14, 17-18, 21-23, 25-27, 31, 38, 40-48, 52, 54-65, 70-72  
74-77, 80-87, 89-95, 98-100, 104, 106, 108-109, 111-112, 114-117, 119-121, 123-128, 130-132, 134-139, 141, 143, 145, 147-150, 154-155, 159, 162-166, 169-170, 174-176, 178, 182, 184-187, 190, 192-196, 199-201, 203, 205, 207, 210-214, 217, 221-224, 226-232, 234-237, 239-245, 247, 249-252, 256, 259-271, 273, 275-278, 280-294, 296, 298-316, 319-320, 322

### **GLOBAL OBJECTION**

Pursuant to Section 5(c) of the Court's November 13, 2014 Order, "the purpose of the parties' proposed findings of fact and conclusions of law is to adduce, *but not argue*, the facts and law that the undersigned should rely on to decide this proceeding. Any proposed findings of fact or conclusions of law that contain such argument will be stricken." Yancey globally objects to the inclusion of argument contained in numerous of the Division's Proposed Findings of Fact. Yancey further requests that this Court strike any Proposed Finding of Fact that contains impermissible argument.

## FINDINGS OF FACT<sup>1</sup>

1. The primary mission of the Securities and Exchange Commission is protection of investors.

a. Response: *No dispute*.

2. One of the ways the Commission protects investors is by implementing rules and regulations. **The purpose** of those rules and regulations is to protect investors.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: One of the ways the Commission protects investors is by implementing rules and regulations. **One** purpose of those rules and regulations is to protect investors.

c. Support:

- Poppalardo Testimony

Q But the first thing you said was protection of investors, right?

A Right.

Q Okay. And how does the Securities and Exchange Commission do that?

A They do that through making rules that govern broker-dealer regulated entities and by ensuring that those rules are carried out through their examination and inspection program, and by bringing enforcement actions.

(Hearing- Day 8, 2005:8-2005:17, Nov. 5, 2014)

Q And so you said firms are -- are subject to thousands of regulations. Again, why is that? Why are firms subject to all those regulations?

A It's -- there's a variety of very complex products that are offered, and there's a lot of services that are offered, and there's just a lot of regulation needed around that to make sure that those products are appropriate, they're offered in a way that the investor understands what they're buying, and it's just -- it's a very complex industry.

Q And at the end of the day, the purpose of every single one of those regulations is to protect investors; is that right?

A Correct.

(Hearing- Day 8, 2006:12-2006:25, Nov. 5, 2014)

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<sup>1</sup> Findings of Fact previously stipulated to pursuant to the Dec. 17, 2014 Order on Stipulations and Transcript Corrections (“Order on Stipulations”) are hereinafter referred to as “Stip. FOF [X].” The Division’s proposed findings of fact are hereinafter referred to as “Div. Prop. FOF [X].”



3. Compliance with the securities laws is extremely important. Market integrity, market structure, and investor protection depend on compliance with the securities laws.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey agreed that** compliance with the securities laws is extremely important. Market integrity, market structure, and investor protection depend on compliance with the securities laws.
- c. Support:
  - Yancey Testimony

<p>Q You would agree with me that compliance with the securities laws is extremely important?</p> <p>A Yes, sir.</p> <p>Q You would agree with me that market integrity depends on compliance with the securities laws?</p> <p>A Yes, sir.</p> <p>Q We can also agree that compliance with the securities laws is important for market structure?</p> <p>A Yes, sir.</p> <p>Q And that compliance with the securities laws is important for investor protection?</p> <p>A Yes, sir.</p>
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(Hearing- Day 3, 876:13-876:25, Oct. 29, 2014)

4. In the securities industry, a business must be operated within the guidelines of the rules.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey agreed that** in the securities industry, a business must be operated within the guidelines of the rules.
- c. Support:
  - Yancey Testimony

<p>Q And that is an important principle because, among other things, market integrity is encompassed in operating your business within the guidelines of the rules, correct?</p> <p>A Yes, sir.</p> <p>Q It's also an important principle because investor protection is encompassed in operating your business within the guidelines of the rules?</p> <p>A Yes, sir.</p> <p>Q And again, it's an important principle because market structure is encompassed in operating your business within the guidelines of the rules?</p> <p>A Yes, sir.</p>
--

Q In fact, we can agree that you can't build a sustainable business if you don't operate within the guidelines of the rules?

A Yes, sir.

(Hearing- Day 3, 877:6-877:22, Oct. 29, 2014)

5. If there is a conflict between the securities laws and industry practice, the securities laws trump.

a. Response: **Dispute** – accuracy of statement.

b. Counterstatement: **Yancey agreed that** if there is a conflict between the securities laws and industry practice, the securities laws trump.

c. Support:

- Yancey Testimony

Q Mr. Yancey, I believe we can also agree that if there's a conflict between, on the one hand, industry practice, and on the other hand, the securities laws, you think the securities laws trump?

A As a principle, yes.

(Hearing- Day 3, 877:1-877:5, Oct. 29, 2014)

Now, I think we agreed yesterday that if industry practice conflicts with securities laws, the securities laws will trump. Do you agree?

A I would.

(Hearing- Day 4, 939:20-939:24, Oct. 30, 2014)

6. Penson Financial Services, Inc. ("PFSI") was a North Carolina corporation with a principal place of business in Dallas, Texas. It was a broker-dealer registered with the Commission. From at least 2010 to 2012, PFSI was one of the largest clearing firms in the United States as measured by the number of correspondent brokers for which it cleared. PFSI was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide, Inc. ("PWI"). PFSI filed a Form BDW, which was effective in October 2012, and then declared bankruptcy in January 2013.

a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 3 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 3 as set forth below.

c. Support:

- Stip. FOF 3

FOF 3. Penson was a North Carolina corporation with a principal place of business in Dallas, Texas. It was a broker-dealer registered with the Commission, which, from at least 2010 to 2012, was one of the largest clearing firms in the United States as measured by the number of correspondent brokers for which it cleared. Penson was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide, Inc. (“PWI”). Penson filed a Form BDW, which was effective in October 2012, and then declared bankruptcy in January 2013. A bankruptcy plan implementing Penson’s liquidation was approved in July 2013.

(See Order on Stipulations; Hearing- Day 10, 2289:11-14, Nov. 7, 2014)

7. PFSI operated under a parent company, Penson Worldwide, Inc. (“PWI”).

- a. Response: ***No dispute***, although the Division’s statement is redundant of Stip. FOF 3 previously stipulated to by all parties and Div. Prop. FOF 6. There is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 3 as set forth below.
- c. Support:
  - Stip. FOF 3

FOF 3. Penson was a North Carolina corporation with a principal place of business in Dallas, Texas. It was a broker-dealer registered with the Commission, which, from at least 2010 to 2012, was one of the largest clearing firms in the United States as measured by the number of correspondent brokers for which it cleared. **Penson was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide, Inc. (“PWI”).** Penson filed a Form BDW, which was effective in October 2012, and then declared bankruptcy in January 2013. A bankruptcy plan implementing Penson’s liquidation was approved in July 2013.

(See Order on Stipulations; Hearing- Day 10, 2289:11-14, Nov. 7, 2014)

8. During the relevant time period, PWI was a public company; it had a number of subsidiaries, including: PFSI; Penson Financial Services, London; Penson Financial Services, Canada; and Nexus Technologies.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 103 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 103 as set forth below.
- c. Support:
  - Stip. FOF 103

FOF 103.	PWI was a public company; it had a number of subsidiaries, including: PFSI; Penson Financial Services, London; Penson Financial Services, Canada; and Nexus Technologies.
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(See Order on Stipulations)

9. Yancey, 58, of Colleyville, Texas, was the President and CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker-dealer. Yancey holds Series 7, 24, 55, and 63 licenses.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 2 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 2 as set forth below.
- c. Support:
  - Stip. FOF 2

FOF 2.	Yancey, 58, of Colleyville, Texas, was the President/CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker/dealer. Yancey holds Series 7, 24, 55, and 63 licenses.
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(See Order on Stipulations; Hearing-Day10, 2288:20-2289:2, Nov. 7, 2014)

10. Delaney, 45, of Colleyville, Texas, was the CCO at Penson from at least October 2008 through April 2011. Delaney currently works in compliance at a registered broker-dealer. He holds Series 4, 7, 24, 27, 53, and 63 licenses.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 1 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 1 as set forth below.

c. Support:

- Stip. FOF 1

FOF 1. Delaney, 45, of Colleyville, Texas, was the CCO at Penson from at least October 2008 through April 2011. Delaney currently works in compliance at a registered broker-dealer. He holds Series 4, 7, 24, 27, 53, and 63 licenses.

(See Order on Stipulations; Hearing-Day 10, 2287:20-23, Nov. 7, 2014)

11. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of PFSI. He had primary authority and responsibility within Stock Loan for its operational practices. Johnson knew that Rule 204T(a)/204(a) required PFSI to close-out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Johnson knew PFSI was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities.

a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 41 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 41 as set forth below.

c. Support:

- Stip. FOF 41

FOF 41. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of Penson. He had primary authority and responsibility within Stock Loan for its operational practices and for the Department's WSPs, which WSPs were incorporated into Penson's WSPs. The Senior Vice President of Stock Loan knew that Rule 204T(a)/204(a) required Penson to close out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Senior Vice President of Stock Loan knew Penson was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities.

(See Order on Stipulations; Hearing-Day 10, 2427:15-2428:4, Nov. 7, 2014)

12. Mike Johnson was charged by the Commission for willfully aiding and abetting the Rule 204 violations at issue in this matter, and settled his case on a neither admit nor deny basis.

a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 104 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 104 as set forth below.

c. Support:

- Stip. FOF 104

FOF 104. Mike Johnson was charged by the Commission for willfully aiding and abetting the Rule 204 violations at issue in this matter, and settled his case on a neither admit nor deny basis.

(See Order on Stipulations)

13. **Johnson was a hostile witness toward the Division**; he believes he was mistreated during the charging and settlement process, and **continues to believe this matter is nothing but a “witch hunt.”**

a. Response: *Dispute*. The Division’s statement consists of impermissible argument in violation of the Nov. 13, 2014 Post-Hearing Order (“Post-Hearing Order”), at ¶ 5(c) and should be stricken.

b. Counterstatement: Johnson testified that he believes he was mistreated during the charging and settlement process and that it “has been a witch hunt.”

c. Support:

- Johnson Testimony

Q Okay. My last question, Mr. Johnson: Did you settle with the SEC in or about March of this year?

A Yes.

Q Do you think you were treated fairly in that process?

A No.

Q Why not?

A Based on FINRA's finding with Merrill Lynch Pro yesterday that came out. And they got a 6 million fine for numerous violations from 2008 forward. They didn't name people. I think this whole thing has been a witch hunt, and none of us -- I only settled because my wife and I are both ill. And I disagree with the whole thing.

(Hearing- Day 2, 562:24-563:11, Oct. 28, 2014)

14. Rudy De La Sierra began working at PFSI in March 2000. He joined the Stock Loan department in June 2000. He became Vice President of Stock Loan in approximately 2006. **He was involved in all functions of the department.**

a. Response: *Dispute*. The Division’s statement is largely redundant of Stip. FOF 105 previously stipulated to by all parties. There is no basis for a separate finding

of fact. Additionally, the Division's statement mischaracterizes the scope of the supporting testimony.

- b. Counterstatement: De La Sierra testified that when he started in the Stock Loan department at Penson, he performed all functions in Stock Lending.
- c. Support:
  - Stip. FOF 105

FOF 105.	Rudy De La Sierra began working at PFSI in March 2000. He joined the Stock Loan department in June 2000. He became Vice President of Stock Loan in approximately 2006.
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(See Order on Stipulations)

- De La Sierra Testimony

Q	Okay. What did you do at Stock Loan at Penson?
---	--

A	What was my role there?
---	-------------------------

Q	Yes, sir.
---	-----------

A	When I -- <b>when I started there, it was all functions.</b> We were operations, including recalls, handling rate changes, some sales lending, the box, our inventory, and borrowing securities as well and also short sale locates.
---	--

Q	So you did all the functions in Stock Lending?
---	--

A	Yes.
---	------

(Hearing- Day 1, 203:8-204:15, Oct. 27, 2014)

15. De La Sierra has entered into a cooperation agreement with the Commission, which requires him to testify truthfully in this proceeding.

- a. Response: ***No dispute.***

16. Lindsey Wetzig began working at PFSI out of college in March 2000. In 2004, he joined the Stock Loan group. In approximately 2006 or 2007, he was promoted to Operations Manager of the Stock Loan group.

- a. Response: ***No dispute,*** although the Division's statement is redundant of Stip. FOF 106 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 106 as set forth below.
- c. Support:
  - Stip. FOF 106

FOF 106. Lindsey Wetzig began working at PFSI out of college in March 2000. In 2004, he joined the Stock Loan group. In approximately 2006 or 2007, he was promoted to Operations Manager of the Stock Loan group.

(See Order on Stipulations)

17. Wetzig was charged by the Commission for his role in the Rule 204 violations at issue in this matter, and settled his case.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Wetzig was charged by the Commission for causing violations of Rule 204T(a) and Rule 204(a) at issue in this matter, and settled his case on a neither admit nor deny basis.
- c. Support:
  - See Exhibit 248, at pp. 1-2, 5

### III.

On the basis of the foregoing, the Respondent hereby:

A. Admits the jurisdiction of the Commission over him and over the matters set forth in the Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”):

1

**Division's Exhibit**

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**A.P. No. 3-15873**

B. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained in the Order, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, consents to the entry of an Order by the Commission containing the following findings<sup>1</sup> set forth below:

### Violations

18. As a result of the conduct described above, Wetzig caused Person's violations of Rules 204T(a) and 204(a). Wetzig knew or should have known his acts or omissions as described above would contribute to these violations.

- Wetzig Testimony



Q You settled with the Division, in this matter, didn't you?  
A That is correct.

(Hearing- Day 2, 403:15-403:17, Oct. 28, 2014)

18. Eric Alaniz was a PFSI compliance department employee from **2009** through 2011. One of Alaniz' responsibilities was to conduct **3012 testing**.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Eric Alaniz was a PFSI compliance department employee from **2008** through 2011. One of Alaniz's responsibilities was to conduct **NASD/FINRA Rule 3012** testing.
- c. Support:
  - Alaniz Testimony

Q Okay. Mr. Alaniz, at some point in time were you employed at Penson Financial Services, Inc.?

A Yes.

Q And when was that?

A My employment began the summer of **2008**. I believe it was June or July.

Q Okay. And how long were you employed at Penson Financial Services, Inc.?

A I believe the summer of 2012, and it was around the same time 20 -- June or July. Q Okay. If I say "PFSI," do you understand that to mean Penson Financial Services, Inc.?

A Yes.

Q And when you were at PFSI, what did you do?

A I conducted the 3012 testing, the 3130 CEO certification, answered general questions, e-mails that came from our correspondents.

Q Okay. Did you reside in a particular department?

A Compliance, yes.

(Hearing- Day 3, 702:19-703:13, Oct. 29, 2014)

Q And you started at Penson in mid-**2008**?

A Correct.

(Hearing- Day 3, 722:1-2, Oct. 29, 2014)

19. Holly Hasty was a PFSI compliance department employee.

- a. Response: **No dispute**.

20. Kim Miller was a PFSI compliance department employee from 2000 until 2012. One of Kim Miller's responsibilities was to provide information in response to requests from regulators and other outside sources.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 107 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 107 as set forth below.
- c. Support:
  - Stip. FOF 107

FOF 107. Kim Miller was a PFSI compliance department employee from 2000 until 2012. One of Kim Miller's responsibilities was to provide information in response to requests from regulators and other outside sources.

(See Order on Stipulations)

21. Phil Pendergraft was one of the creators of Penson.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: Phil Pendergraft testified that he had a role in the creation of the U.S. broker-dealer and the changing of its name to "Penson."
- c. Support:
  - Pendergraft Testimony

Q Okay. And did you have a role in the creation of Penson, the changing of the name and the creation of the broker-dealer at that time?

A Yes, ma'am.

Q And what was that?

A Well, Dan Son and I viewed ourselves as partners, although Dan was the one who purchased the broker-dealer. And so we were the first two employees of Penson.

Q Okay. How was the name "Penson" created?

A Penson is an amalgamation of my name and Daniel Son's name, it's "Pen" and "Son."

(Hearing- Day 6, 1456:4-1456:15, Nov. 3, 2014)

22. From 2008 to 2011, Pendergraft was chief executive officer and a member of the board of directors of PWI.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: From **at least** 2008 to 2011, Pendergraft was chief executive officer and a member of the board of directors of PWI, **as well as an associated person and the Executive Vice President of PFSI – the U.S. broker-dealer.**

c. Support:

- Stip. FOF 75

FOF 75.	During the relevant period Phil Pendergraft was an executive vice president of PFSI.
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- Pendergraft Testimony

Q	Okay. Let's talk about from 2008 to 2011. What was your role at PWI during that time period?
---	--

A	I would have been the chief executive officer and a member of the board of directors of PWI.
---	--

(Hearing- Day 6, 1459:13-1459:16, Nov. 3, 2014)
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Q	Now, you were -- in addition to being the CEO of PWI, were you also an officer of PFSI?
---	---

A	Yes, sir.
---	-----------

Q	And in that capacity, were you the executive vice president of PFSI?
---	--

A	For some period of time, yes.
---	-------------------------------

Q	Were you a registered person and did PFSI hold your licenses?
---	---

A	Yes, sir.
---	-----------

(Hearing-Day 6, 1513:25-1514:8, Nov. 3, 2014)
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23. During the Division's investigation of this matter, Yancey encouraged the Division to take testimony from Pendergraft in order to properly understand the supervisory structure over Johnson and Stock Loan.

a. Response: **Dispute** – accuracy of statement.

- b. Counterstatement: During the Division's investigation of this matter, **Yancey's lawyers – through his wells submission** – encouraged the Division to take testimony from Pendergraft in order to properly understand the supervisory structure over Johnson and Stock Loan.

c. Support:

- Yancey Testimony

Q	All right. So in your Wells submission, you said that not speaking to Mr. Pendergraft lacked prudence and logic, right?
---	---

A	<b>These are the words of my lawyers.</b>
---	---

(Hearing-Day 4, 992:7-10, Oct. 30, 2014)
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- Ex. 229 at 10

The staff's failure to speak with Mr. Pendergraft and Mr. Kenny, the individuals with direct oversight for Stock Loan and Operations and the individuals who knew and discussed Rule 204 violations, lacks prudence and logic. It is a chasm in the investigation that allows the staff to ignore Mr. Yancey's separation from these departments and from the Reg SHO concerns. It also illustrates the staff's baseless rush to judgment regarding Mr. Yancey.

- Ex. 230 at 16

Because the staff is conducting further investigation and taking additional testimony from Mr. Delaney, we believe it is prudent and important for the staff to seek information from Mr. Kenny and Mr. Pendergraft before reaching a conclusion on the investigation. A failure to do so is unfair to both the Commission and to Mr. Yancey, who are deprived of the full scope of information regarding the reporting structuring of the Stock Loan department and discussions of Reg SHO concerns.

- Yancey Testimony

Q Do you recall, **in these Wells submissions**, encouraging the staff of the Division to talk to Phil Pendergraft?

A **After conferring with Counsel.**

Q And please don't tell me what you and your counsel discussed, but again --

A I did encourage that -- Mr. Pendergraft's testimony, yes.

(Hearing- Day 4, 990:10-990:17, Oct. 30, 2014)

24. Bart McCain began working at PFSI in 2006. He was PFSI's chief administrative officer, and also served as PFSI's chief financial officer for a time. McCain also served as the PWI interim treasurer in 2011 and interim chief financial officer in 2012.

- Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 108 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- Counterstatement: Stip. FOF 108 as set forth below.
- Support:
  - Stip. FOF 108

FOF 108. Bart McCain began working at PFSI in 2006. He was PFSI's chief administrative officer, and also served as PFSI's chief financial officer for a time. McCain also

served as the PWI interim treasurer in 2011 and interim chief financial officer in 2012.

(See Order on Stipulations)

25. Yancey **was instrumental in securing every job McCain had in the securities industry**, including hiring McCain to work at PFSI.

- a. Response: Dispute – overly broad and not supported by testimony. The Division’s statement also constitutes impermissible argument. See Post-Hearing Order ¶ 5(c).
- b. Counterstatement: Yancey hired McCain to work at PFSI.
- c. Support:
  - McCain Testimony

Q In fact, your first job in the securities industry was at Southwest Securities; is that right?  
A Yes.  
Q And Bill Yancey hired you?  
A Yes.  
Q And then you went to Automated Trading Desk? Do I have that right?  
A Yes.  
Q And I think you said to Ms. Addleman earlier Mr. Yancey made the introduction between you and the CFO of Automated Trading Desk; is that right?  
A Yes.  
Q You left Automated Trading Desks to go to Penson; is that right?  
A I did.  
Q And Mr. Yancey had left ATD before you, right?  
A Yes.  
Q And when you were at ATD -- well, let me take a step back.  
Mr. Yancey then reached out to you about coming to Penson, right?  
A He did about a year after he left.  
Q About a year after he left.  
And at that time, you were having a lot of success at ATD, right?  
A I was.  
Q It was a great firm, doing well; you weren't being asked to leave, right?  
A Right.  
Q You didn't have any pressure to leave ATD?  
A No.  
Q There was no discussion of leaving ATD?  
A No.

(Hearing- Day 9, 2235:22-2237:5, Nov. 6, 2014)

26. McCain and Yancey have a close personal and professional relationship. McCain considers Yancey his dearest friend, **and feels indebted to Yancey for, among other things, the bonus payments he received while at PFSI.**

- a. Response: **Dispute** – overly broad and not supported by testimony. The Division’s statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- b. Counterstatement: **McCain testified that** he has a close personal and professional relationship with Yancey. McCain **testified that he** considers Yancey his dearest friend.
- c. Support:
  - McCain Testimony

Q Did you ever address Mr. Yancey as your dearest friend?

A I'm sure I have.

Q In fact, is it fair to say there were times in your career at Penson that Mr. Yancey was the only one you could talk to without filtering your thoughts?

A Outside of my wife, yes.

Q Did you and Mr. Yancey ever exchange birthday gifts?

A Yes.

Q Do you recall giving him a set of picture frames as a reminder of a trip to Pebble Beach that you and Mr. Yancey took?

A Yes.

(Hearing- Day 9, 2238:1-2238:14, Nov. 6, 2014)

Q You were thankful to Mr. Yancey for your bonuses; is that fair?

A Of course.

(Hearing- Day 9, 2238:25-2239:2, Nov. 6, 2014)

Mr. McCain, it's fair to say you and Mr. Yancey are close professionally?

A Yes.

Q You're close personally?

A Yes.

(Hearing- Day 9, 2240:2-2240:6, Nov. 6, 2014)

- Ex. 276

**To:** Bill Yancey[BYa [REDACTED]@COM]  
**From:** Bart McCain  
**Sent:** Sat 3/12/2011 3:33:23 PM  
**Importance:** Normal  
**Subject:** Thank you!

William,  
 I never thanked you for my bonus, both cash and equity. As always, Bill, I so appreciate all that you do for me, and this is no exception. I'm so thankful for the day that you invited me to join you at SWST, but more thankful for the day we met. I'm a better person because of you, as you set an extraordinarily high standard to emulate. Thank you, my friend, for all that you do for me.

I hope you had a great week at Wharton, and that I (or anyone else) intruded on it too much.

Bart

27. In contrast to his loyalty to Yancey, McCain was hostile toward Pendergraft.
- Response: *Dispute* – overly broad and not supported by testimony. The Division's statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
  - Counterstatement: McCain testified that he was disappointed in Pendergraft's actions regarding McCain's transition to Chief Financial Officer at PWI in 2012.
  - Support:
    - McCain Testimony

A Phil, I believe, was a -- **until, say, 2012**, just before the Apex transaction, I believe Phil to be a very honorable person, but in retrospect, the way the transition from -- or the **transition of me into the CFO role** and the way that occurred, and his departure within six to eight weeks after that, I felt like he fled the company when it was just, frankly, teetering. **He made representations to me that my role would be interim.** He made representations that we were going to survive after the Apex transaction. And neither of those were true. **Very disappointed.** He left me holding the bag, frankly.

(Hearing- Day 9, 2177:8-2177:19, Nov. 6, 2014)

28. Brian Gover began working at PFSI in April, 2007. Over time he managed several departments, including the buy-ins department. In April 2012, Gover moved into the compliance department at PFSI. He is currently the Chief Compliance Officer of Apex Clearing.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 109 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 109 as set forth below.
- c. Support:
  - Stip. FOF 109

FOF 109.	Brian Gover began working at PFSI in April, 2007. Over time he managed several departments, including the buy-ins department. In April 2012, Gover moved into the compliance department at PFSI. He is currently the Chief Compliance Officer of Apex Clearing.
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(See Order on Stipulations)

29. Summer Poldrack and Angel Shofner were PFSI employees in the Buy-ins department during the relevant time period.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 110 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 110 as set forth below.
- c. Support:
  - Stip. FOF 110

FOF 110.	Summer Poldrack and Angel Shofner were PFSI employees in the Buy-ins Department during the relevant time period.
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(See Order on Stipulations)

30. The Depository Trust and Clearing Corporation ("DTCC") operates the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. When NSCC members purchase or sell securities on the exchanges, the exchanges send the trade information to the NSCC. NSCC operates the Continuous Net Settlement ("CNS"). NSCC member clearing firms receive reports that, as of at least close of business T+1, notify the firms of transactions scheduled to clear and settle by close of business T+3. CNS also sends reports to the firms listing net fails to deliver in each security as of T+3.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 5 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.



b. Counterstatement: Stip. FOF 5 as set forth below.

c. Support:

- Stip. FOF 5.

FOF 5. The Depository Trust and Clearing Corporation ("DTCC") operates the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. When NSCC members purchase or sell securities on the exchanges, the exchanges send the trade information to the NSCC. NSCC operates the Continuous Net Settlement ("CNS"). NSCC member clearing firms receive reports that, as of at least close of business T+1, notify the firms of transactions scheduled to clear and settle by close of business T+3. CNS also sends reports to the firms listing net fails to deliver in each security as of T+3.

(See Order on Stipulations; Hearing-Day 10, 2293:21-24, Nov. 7, 2014)

31. If a trade fails to settle, there are consequences to the buyer of the shares, and to the market more generally. For example, the buyer does not receive certain rights that come along with owning shares.

a. Response: **Dispute** – accuracy of statement; contrary testimony.

b. Counterstatement: Isolated fails to deliver have minimal effect on systemic risk, in part due to the design of CNS and NSCC.

c. Support:

- Harris Testimony

A Why the Commission adopted these rules is not relevant to the -- to the settlement of this case or to its conclusion.

(Harris, 1073:1-3, Oct. 30, 2014)

- Sirri Testimony

Q And on your third bullet point you indicate  
**"Isolated fails to deliver at brokers have a minimal effect on systemic risk, in part due to the design of CNS and NSCC." What do you mean by that?**

A There can be fails to deliver. In that

situation, the receiving broker will often not get the shares they want. In that world, Professor Harris makes the point that that broker is exposed to a certain amount of risk if the shares don't settle by T+3 or say the morning of T+4. **There's two points I wanted to make. The first is that by that point the counterparty to the trade is NSCC. NSCC becomes the counterparty to the trade as the central counterparty on the midnight of T+1, so the trade is locked in and guaranteed by the NSCC. That's a pretty strong guarantee. So the nonperformance of the fail to deliver position does not affect the fail to receive position.**

(Hearing – Day 6, 1609:18-1610:10, Nov. 3, 2014)

32. Rule 204T/204 was adopted to, among other things, address prolonged failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 4 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 4 as set forth below.
- c. Support:
  - Stip. FOF 4

FOF 4. Rule 204T/204 was adopted to, among other things, address prolonged failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009.

(See Order on Stipulations; Hearing-Day 10, 2290:1-4, Nov. 7, 2014)

33. At all relevant times, PFSI was a clearing firm, i.e., a participant of a registered clearing agency and a member of NSCC. As a clearing firm, PFSI had obligations under Rule 204(a) to close-out CNS failures to deliver resulting from long sales no later than market open T+6.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 6 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 6 as set forth below.

c. Support:

- Stip. FOF 6

FOF 6.	At all relevant times, Penson was a clearing firm, i.e., a participant of a registered clearing agency and a member of NSCC. As a clearing firm, Penson had obligations under Rule 204(a) to close out CNS failures to deliver resulting from long sales no later than market open T+6.
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(See Order on Stipulations; Hearing-Day 10, 2294:8-11, Nov. 7, 2014)

34. No PWI entity other than PFSI had close-out obligations under Rule 204.

a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 111 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 111 as set forth below.

c. Support:

- Stip. FOF 111

FOF 111.	No PWI entity other than PFSI had close out obligations under Rule 204.
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(See Order on Stipulations)

35. From October 2008 until November 2011, PFSI failed to close-out CNS failures to deliver resulting from long sales of loaned securities by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, PFSI is permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties. PFSI re-hypothecated margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA").

a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 7 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 7 as set forth below.

c. Support:

- Stip. FOF 7

FOF 7. From October 2008 until November 2011, Pension failed to close out CNS failures to deliver resulting from long sales of loaned securities by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, Pension is permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties. Pension re-hypothecated margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA").

(See Order on Stipulations; Hearing-Day 10, 2298:24-2299:3, Nov. 7, 2014)

36. When a margin customer sold the hypothecated securities that were out on loan, PFSI issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. When the borrowers did not return the shares by the close of business T+3, and PFSI did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, PFSI incurred a CNS failure to deliver.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 8 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 8 as set forth below.
- c. Support:
  - Stip. FOF 8

FOF 8. When a margin customer sold the hypothecated securities that were out on loan, Pension issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. When the borrowers did not return the shares by the close of business T+3, and Pension did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, Pension incurred a CNS failure to deliver.

(See Order on Stipulations; Hearing-Day 10, 2303:23-2304:8, Nov. 7, 2014)

37. It was Stock Loan's obligation to close-out CNS fails arising from long sales of loaned securities.

- a. Response: *No dispute*.

38. By contrast, PFSI's Buy-ins department had the responsibility to close-out CNS fails caused by customers by buying in the shares owed, e.g., customer short sales. The cost of the buy-in, and the attendant market risk, was borne by the customer or broker causing the fail.

- a. Response: *Dispute* – accuracy of statement.

- b. Counterstatement: PFSI's Buy-ins department had the responsibility to close-out CNS fails caused by customers by buying in **or borrowing** the shares owed, *e.g.*, customer short **and long** sales. The cost of the buy-in, and the attendant market risk, was borne by the customer or broker causing the fail.
- c. Support:
- Gover Testimony

Q Okay. What did buy-ins do at PW- -- PFSI?

A Well, we certainly handled the Reg SHO buy-ins, and we can, I imagine, talk about that. We also handled broker-to-broker buy-ins. So if we had trades that were not selling perhaps through CNS, that they were selling just DTC trade for trade, if we were failing to receive from a party, we -- we could issue a -- a buy-in. If we were failing to deliver on a position and another firm issued us a buy-in, we would look at it and either -- retrans is the industry jargon -- we were retransmitting the buy-in to the party that owes you the shares, or, you know, if it was due to a failure on our part, we would -- we would handle those buy-ins. I mean, if we were being bought in, notified we were being bought in, making sure we were ascribing the buy-in costs correctly to the party that caused it.

Q Okay. What do you mean by "buy-in"?

A You're going to market and you are buying shares at the market. So let's go back to the trade settlement. And you have a contractual agreement or your customer has a contractual agreement to sell -- sell 100 shares of IBM and deliver them for X amount of money. If the party that is not -- that is due to receive those 100 shares of IBM doesn't receive them, they -- they have some recourse which -- to prevent them from having undue financial risk and they can -- they can buy it in. They can go and say, hey, the broker was supposed to deliver this to me. He didn't deliver it. I need to have the shares because I have to deliver them to somebody else. I'm notifying you, I'm buying you in at the market. And they go buy the shares that you were supposed to deliver to them. So now they've -- they've fulfilled their obligation that they can -- they had to buy the shares so they can make forward delivery or to give them to your customer who they're owed. The party that should have delivered them to them now has market risk because now they've got shares that they -- they don't need to deliver them anymore. That -- that receiving firm no longer needs them because they bought in. So that's -- that's the core of it. You are -- generally with buy-ins, it's -- you're -- you are -- it's a very risk manage- -- it's a risk-management-centered function.

Q And who bears the cost of that buy-in?

A In general terms, whoever caused it.

Q Okay. Whoever caused what?

A The buy-in. So, you know, if -- if you have a customer that caused a buy-in, there's a whole bunch of different kinds of -- you know, different types of trades. But let's say that they have a physical certificate, and they go to deliver the shares to the transfer agent, who is then going to re-register them into the street name for Penson, and they sell the shares. But if you don't have the shares to deliver and they sold them before they were cleared through the agent, and we get bought in, or we get notified that we're going to be bought in, we're going to pass those costs back to the customer. If it's another broker that's failing to deliver to us and -- and Penson is buying in, we're -- we're putting that cost back to that broker who is failing to deliver to us. If

it's Penson that is being bought in or should have been bought in, generally Penson is going to have the market risk and the cost on it. So it's whichever party is causing the buy-in is the one that is going to bear the market risk and the cost.

(Hearing- Day 1, 87:13-90:3, Oct. 27, 2014)

- Wetzig Testimony

Q I want to talk about who, at Penson, had the responsibilities to deal with those various things. So let's start with customer short sales. What was the process at Penson for closing out a customer short sale by market open T+4? A So we would get in on T+4 at around 6:00 in the morning, and we would receive a list, the potential 204 customer closeouts, and we would try to go borrow those items before the market opened.

Q And when you say "we," who's the we in that sentence?

A Rudy would try to borrow the items, initially, and Dawnia would forward the items to me, and I would try it as well.

Q So that -- you're talking about people in Stock Lending?

A Correct.

Q Okay. So on the morning of T+4, after Stock Lending had tried to borrow to cover the customer shorts, were you successful in covering some of the shorts? A We were successful in covering most of the shorts.

Q Okay. So if Stock Lending couldn't borrow to cover a customer short, what happened next?

A We would send the list back down to the buy-in department. And then they would receive that list and send me instructions, to the trade desk, to close-out the customer short sales.

...

Q What did buy-ins then do with the list?

A They would send those securities to the trade desk for execution.

Q And "execution" means -- means what?

A They would buy the customer's short sale.

Q So that was handled by the buy-ins group?

A Correct.

(Hearing- Day 2, 361:24-364:3, Oct. 28, 2014)

- De La Sierra Testimony

Q And let's -- let's talk about those two processes. So on T3, if you queried and determined it was the result of a short sale, what did Stock Lending do?

A We would put our list together and start borrowing --

Q Who was the borrower?

A There was a lot of those as well. So part of that was what it put -- the Dawnia Robertson reviews is loaded up into LoanNet to try to automate some of these borrows.

Q So when there's a fail due to a short sale on T3, Stock Lending tries to borrow to cover that fail?

A That is correct.

Q What about on T4? Does Stock Lending do anything on T4?

A If the customer requested us to borrow it, we would attempt to borrow it in the morning of T4 before the opening.

Q And if Stock Lending couldn't borrow on the morning of T4 before the open, what would Stock Lending do?

A We'd notify the buy-ins group.

(Hearing- Day 1, 230:21-231:18, Oct. 27, 2014)

39. PFSI violated Rule 204T/204 at least 1500 times during the time period relevant to this case.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 49 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 49 as set forth below.
- c. Support:
  - Stip. FOF 49

FOF 49. During the relevant time period there were at least 1,500 Rule 204T(a)/204(a) violations by PFSI relating to long sales of loaned securities.

(See Order on Stipulations; Hearing-Day 10, 2468:25-2469:4, Nov. 7, 2014)

40. PFSI violated Rule 204T/204's requirement to close-out at market-open T+6 approximately 2-10 times each trading day.

- a. Response: **Dispute**. The Division's statement is redundant given Stip. FOF 49 regarding the number of violations previously stipulated to by all parties. There is no basis for a separate or additional finding of fact.
  - i. Alternatively, Yancey objects based on the accuracy of the statement.
- b. Counterstatement: Stip. FOF 49 as set forth below.
  - i. Alternatively, Yancey suggests the following counterstatement based on accuracy:

**De La Sierra and Wetzig testified that PFSI violated Rule 204T/204's requirement to close-out at market-open T+6 approximately 2-10 times each trading day.**
- c. Support:

FOF 49. During the relevant time period there were at least 1,500 Rule 204T(a)/204(a) violations by PFSI relating to long sales of loaned securities.

(See Order on Stipulations; Hearing-Day 10, 2468:25-2469:4, Nov. 7, 2014)

- De La Sierra Testimony

Q Mr. De La Sierra, how frequently was Stock Lending buying in on the afternoon of T+6?

A It would have been daily.

Q And do you recall how many instances each day?

A It could be -- it would vary. A couple to, you know, a few.

(Hearing- Day 1, 227:22-228:2, Oct. 27, 2014)

- Wetzig Testimony

Q On average, how many times during the week were you buying someone in, at the end of the day, on T+6?

A I would say, on average, two to three times a day we bought somebody in. Q Two to three times a day?

A Correct.

Q All right. Now, if I understood you right, that would only happen if the obligation -- excuse me -- if the deficit still existed at the end of the day on T+6; is that right?

A That is correct.

Q Are there times where that deficit could have cleaned up during the day on T+6?

A That is correct.

Q Do you have a sense of -- so we talked about at the end of the day, there were two to three buy-ins every day. Do you have a sense of, at the beginning of the day at market open T+6, how often -- or how many open deficits there still were?

A I would say, maybe, eight to ten.

Q On -- on every day?

A Correct.

(Hearing- Day 2, 370:18-371:14, Oct. 28, 2014)

41. While many trades naturally settled prior to market-open T+6, when a settlement failure reached market-open T+6, which is the point at which Rule 204 says PFSI must take action to close-out the fail, PFSI Stock Loan took no action to close-out the fail. Thus, 100% of the fails that reached the point where Rule 204 required action were not closed out on time.

a. Response: **Dispute** – accuracy of statement; contrary testimony.

b. Counterstatement: While many trades naturally settled prior to market-open T+6, when a settlement failure reached market-open T+6, **on some occasions**, Stock Loan **did attempt to borrow or buy in** shares before market open T+6 to close-out fails to deliver caused by long sales of loaned securities. **On some occasions**



PFSI Stock Loan took no action to close-out the fail. Thus, **some** of the fails that reached the point where Rule 204 required action were not closed out on time.

c. Support:

- Johnson Testimony

Q Sure. Maybe I'll ask you more broadly. From 2008 to 2011, when on T6 did Stock Lending buy in to close out fails to deliver?

A I think **we bought in in the morning and then throughout the day.**

Q On T+6?

A Yes.

(Hearing-Day 2, 515:9-15, Oct. 28, 2014)

- De La Sierra Testimony

Q Now, I believe there was a time when Stock Loan did begin trying to borrow before the morning of T+6, is that right, to –

A I believe –

...

A -- there was a few times where **it was attempted.**

(Hearing, Day 1, 306:14-20, Oct. 27, 2014)

- Sirri Testimony

Q Is it fair to say that persistent failures to deliver can be consistent with Rule 204, compliance with Rule 204?

A You can have a situation in a security where there's a persistent fail to deliver and the people who are trading that security absolutely are complying with the requirements of Rule 204.

Q And is that when they purchase on at market open?

A An example would be someone sells stock on AT short, you reach beginning of market open T+4, they buy shares to cover the short position. Those shares would settle on T+7, so you will show a fail to deliver system -- in the system from T+3 to T+7, and then they establish a new short position on, say, T+5. So you may see a long string of these, or perhaps another short position on T+4 later in the day. **You can see a long string of fail to delivers. That doesn't mean someone is not complying with the rule.**

(Hearing-Day 6, 1605:10-1606:3, Nov. 3, 2014)

42. It is not surprising that only a small percentage of all trades PFSI cleared violated Rule 204, because the vast majority of all trades settle on time, *i.e.*, by T+3. That fact does not excuse or diminish PFSI's Rule 204 violations.

- a. Response: **Dispute.** The Division's statement consists of impermissible argument and should be stricken. *See* Post-Hearing Order ¶ 5(c). Additionally, the

Division's statement is redundant of Stip. FOF 49 previously stipulated to by all parties. There is no basis for a separate finding of fact.

b. Counterstatement: Stip. FOF 49 as set forth below.

c. Support:

FOF 49. During the relevant time period there were at least 1,500 Rule 204T(a)/204(a) violations by PFSI relating to long sales of loaned securities.

(See Order on Stipulations; Hearing-Day 10, 2468:25-2469:4, Nov. 7, 2014)

43. There would have been substantial costs to PFSI if it had bought shares at market-open T+6, without being able to pass those costs on to customers.

a. Response: **Dispute**. The Division's statement is unsubstantiated conjecture and redundant of existing stipulated findings of fact regarding the benefits to PFSI. There is no basis for a separate finding of fact.

b. Counterstatement: During the relevant time period the only specifically quantified benefit PFSI gained from not timely closing out at market open on T+6 is \$59,000.

c. Support:

- Stip. FOF 53

FOF 53. During the relevant time period the only specifically quantified benefit PFSI gained from not timely closing out at market open on T+6 is \$59,000.

(See Order on Stipulations)

- Stip. FOF 80

FOF 80. The total calculated benefit to Penson from the 204(a) violations at issue is only approximately 0.08 percent of Stock Loan's total revenue during the relevant period.

(See Order on Stipulations)

- Johnson Testimony

Q: Are you aware, Mr. Johnson, that the SEC alleges in this lawsuit that the reason Penson was violating Rule 204 was for a profit motive? Have you heard that?

A: Yes.

Q: What do you think about that?

A: I think it's bull crap.

Q: In your view, was there material economic benefit to Pension for the conduct they're alleged to have committed with respect to Rule 204? A: I think what you're saying is, was it worth it if we broke the rule. No. We wouldn't -- we didn't do the rule because we didn't understand how to do it. We did not do it for money.

(Hearing-Day 2, 539:23-540:11, Oct. 28, 2014)

44. Stock Loan **did not attempt** to borrow shares before market open T+6 to close-out fails to deliver caused by long sales of loaned securities.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **On some occasions, Stock Loan did attempt to borrow or buy in** shares before market open T+6 to close-out fails to deliver caused by long sales of loaned securities.
- c. Support:
  - Johnson Testimony

Q Sure. Maybe I'll ask you more broadly. From 2008 to 2011, when on T6 did Stock Lending buy in to close out fails to deliver?

A I think **we bought in in the morning and then throughout the day**.

Q On T+6?

A Yes.

(Hearing-Day 2, 515:9-15, Oct. 28, 2014)

- De La Sierra Testimony

Q Now, I believe there was a time when Stock Loan did begin trying to borrow before the morning of T+6, is that right, to –

A I believe –

...

A -- there was a few times where **it was attempted**.

(Hearing, Day 1, 306:14-20, Oct. 27, 2014)

45. If Stock Loan had decided to close-out fails on the morning of T+6 by buying shares in its own proprietary account, as opposed to buying in the borrowing counterparty, that decision would have had to be approved at a **very high level** within PFSI because taking a proprietary position could expose the firm to significant losses.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **De La Sierra and Wetzig testified that** if Stock Loan had decided to close-out fails on the morning of T+6 by buying shares in its own

proprietary account, as opposed to buying in the borrowing counterparty, that decision would have had to be approved by **Mike Johnson or Phil Pendergraft** because taking a proprietary position could expose the firm to significant losses.

c. Support:

- De La Sierra Testimony

Q ... [I]f Stock Lending had bought in on Penson's own propriety account on the morning of T+6, is that something you think you would have had authority to do?

A I would not have, no.

Q Why not?

A **Well, now you're taking proprietary positions in illiquid names, and that would have had to have been approved above me, probably above Mike Johnson.**

Q What's the risk with taking shares in proprietary?

A It's market risk. And, like I said, these are illiquid names, so any small movement -- or I'm sorry -- any trading of these could create large moves in stock price. And now you're proprietary -- I mean, we're not traders. We're Stock Loan. We're just -- we're agents. We're lending securities that are -- are inventory.

Q I see.

Help me understand. What is the risk, though, that -- if you hold it and the markets moves, so what?

A Big -- large losses.

(Hearing- Day 1, 228:6-229:2, Oct. 27, 2014)

Q -- discussion? Okay. And that discussion was in the context of when you were talking about Rule 204 with Mr. Heinke; isn't that right?

A Yes.

Q Okay. And why would Penson buy in on their own propriety account?

A If they wanted to be long of security.

Q Okay. And how -- sorry. How does that fit in with Rule 204?

A It doesn't.

Q Okay. Would that be a -- a PFSI activity though --

A It would --

Q -- something your group would handle?

A It would be PFSI.

Q Okay. I think you said that that approval for that activity might have to go above -- above Mike Johnson --

A Yes.

Q -- I believe is what you said? In fact, Phil would have to approve that activity, right?

A **You would probably go to Phil.**

(Hearing-Day 1, 307:2-25, Oct. 27, 2014)

- Wetzig Testimony

Q Well, why couldn't Stock Loan or Penson just buy those positions in?  
A That wouldn't have been my decision.  
Q Pardon?  
A That would not have been a decision that I could have made.  
...  
A If they would have told me to close-out, I would have closed out. That was not my decision to make.  
Q **Whose decision was it?**  
A **That would be Mike Johnson, Senior Vice President of Stock Loan.**  
Q So he was in there telling you how to make every decision on your management job?  
A No. He was not telling me how to make every decision, but taking a large dollar position on proprietary trading would have gone to him.  
Q So you would have had to clear a 204 buy-in through Mike Johnson?  
A Yes, that is correct.

(Hearing- Day 2, 395:3-396:14, Oct. 28, 2014)

Q And one of the things you said, if I heard you right, is that something about taking a large dollar position on a proprietary trade wasn't something you would have authority to do. Do you recall that?  
A Yes, sir, I do.  
Q What did you mean by that?  
A That wouldn't have been my decision to make, to buy ourselves in on one, on T+6, without any coverage.  
Q Why not?  
A Because we would have large market risk exposure if we were to buy ourselves in. It would be long, that security.  
Q Large market risk and exposure. And if you're long on a security with large market risk and exposure, what -- what does that risk mean in real world terms?  
A So depending on the change in the stock price, you can essentially lose a lot of money very quickly.

(Hearing- Day 2, 425:6-425:22, Oct. 28, 2014)

46. It was not typical for PFSI to buy stock in its proprietary account.

- a. Response: ***Dispute*** – accuracy of statement.
- b. Counterstatement: **Wetzig agreed that** it was not typical for PFSI to buy stock in its proprietary account.
- c. Support:
  - Wetzig Testimony

Q And was it not typical for Penson to buy positions in its proprietary account?  
A That is correct.

(Hearing- Day 2, 425:23-425:25, Oct. 28, 2014)

47. Had PFSI Stock Loan been buying in for PFSI's proprietary account at market-open T+6, that is something that would have been a big deal and a topic of conversation at the firm.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Wetzig testified that** had PFSI Stock Loan been buying in for PFSI's proprietary account at market-open T+6, that is something that would have been a fairly big deal and a topic of conversation at the firm.
- c. Support:
  - Wetzig Testimony

Q Would it have been, in your view, a -- a big deal if Penson started buying itself in on T+6 in its proprietary account?

A I think it would have been a fairly big deal.

Q You think you would have had to go -- I think you said this. But you would have had to go up the chain, correct?

A Yes, sir, that is correct.

Q And it's something, in your view, people at the firm would have been talking about, that's something Penson was doing?

A Absolutely.

(Hearing- Day 2, 426:1-426:12, Oct. 28, 2014)

48. Buying in a borrowing counterparty allowed PFSI to pass the risks involved without taking a proprietary position along to the counterparty.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **De La Sierra testified that** executing buy-ins at the end of the day on T+6 allowed PFSI to pass certain losses along to the customer or counterparty.
- c. Support:
  - De La Sierra Testimony

Q ... What is the risk, though, that -- if you hold it and the markets moves, so what?

A Big -- large losses.

Q Large losses.

Why wasn't that a risk when you were doing your buy-ins at the end of the day on T+6?

A Because those you pass along to your customer or to the counterparty.

(Hearing- Day 1, 228:25-229:3, Oct. 27, 2014)

49. Prior to the implementation of Rule 204T, PFSI issued recalls for stock that it had loaned out, but was now needed to fulfill a settlement obligation, on T+3. Based on PFSI's recall letter, as well as the terms of the MSLA, the borrowing counterparty had until the end of the third business day after receiving the recall (*i.e.*, until the end of the day on T+6) to return the shares. If they did not return the shares by the end of the day on T+6, at that point PFSI would buy the counterparty in.

a. Response: *No dispute*.

50. Stock Loan personnel, including Mike Johnson, understood that Rule 204 required close-outs of fails to deliver related to long sales of loaned securities at market-open T+6.

a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 41 and 70 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 41 and 70 as set forth below.

c. Support:

- Stip. FOF 41

FOF 41. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of Penson. He had primary authority and responsibility within Stock Loan for its operational practices and for the Department's WSPs, which WSPs were incorporated into Penson's WSPs. The Senior Vice President of Stock Loan knew that Rule 204T(a)/204(a) required Penson to close out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Senior Vice President of Stock Loan knew Penson was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities.

(See Order on Stipulations; Hearing, Day 10, 2427:15-2428:4, Nov. 7, 2014)

- Stip. FOF 70

FOF 70. Members of Penson's Stock Loan Department at all times knew that Rule 204T or 204 required them to close out all long sale transactions by market open at or before market open on T+6.

(See Order on Stipulations; Hearing, Day 10, 2505:1-4, 7-9, Nov. 7, 2014)

51. When 204T was implemented, PFSI Stock Loan initially attempted to close-out fails to deliver related to long sales of loaned securities on the morning of T+6. However, because the recall had not been issued until T+3, the counterparties would not accept the buy-in on the morning of T+6, and instead insisted that they had until the end of the day on T+6 to return the borrowed shares.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 10 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 10 as set forth below.
- c. Support:
  - Stip. FOF 10

FOF 10.	Stock Loan initially attempted to comply with Rule 204T for long sales of loaned securities by recalling loans at the account level on T+3 and buying in the borrowers at market open T+6. However, because the MSLA gave the borrowers three full days (until close-of-business T+6) to return the shares, the borrowing counterparties pushed back against Penson's attempted market-open T+6 buy ins.
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(See Order on Stipulations; Hearing, Day 10, 2308:6-9, 7-9, Nov. 7, 2014)

52. Stock Loan determined that it would not close-out fails to deliver related to securities that had been loaned until the end of the day on T+6, at which time it would buy-in the counterparty.

- a. Response: *Dispute* – The Division's statement is redundant of Stip. FOF 11 previously stipulated to by all parties. Stip. FOF 11 reflects a more accurate recitation of the testimony and evidence set forth at trial. Alternatively, the statement is inaccurate given testimony from both Johnson and De La Sierra contradicts the Division's statement.
- b. Counterstatement: Stip. FOF 11 as set forth below.
  - i. In the alternative, the Division's Prop. FOF should state as follows:

**On some occasions**, Stock Loan **did attempt** to borrow **or buy in** shares before market open T+6 to close-out fails to deliver caused by long sales of loaned securities.

- c. Support:
  - Stip. FOF 11

FOF 11.	At least on some occasions, Stock Loan allowed CNS failures to deliver resulting from long sales of loaned securities to persist beyond market open T+6. At least
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on some occasions, Stock Loan personnel did not take steps, such as purchasing or borrowing securities, in order to close out Penson's CNS failure-to-deliver position.

(See Order on Stipulations; Hearing-Day 10, 2315:11-19, Nov. 7, 2014)

- Johnson Testimony

Q Sure. Maybe I'll ask you more broadly. From 2008 to 2011, when on T6 did Stock Lending buy in to close out fails to deliver?

A I think **we bought in in the morning and then throughout the day.**

Q On T+6?

A Yes.

(Hearing-Day 2, 515:9-15, Oct. 28, 2014)

- De La Sierra Testimony

Q Now, I believe **there was a time when Stock Loan did begin trying to borrow before the morning of T+6**, is that right, to –

A I believe –

...

A -- there was a few times where **it was attempted.**

(Hearing, Day 1, 306:14-20, Oct. 27, 2014)

53. Mike Johnson knew that Stock Loan was not closing out fails to deliver at market open T+6.

a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 41 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 41 as set forth below.

c. Support:

- Stip. FOF 41

FOF 41. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of Penson. He had primary authority and responsibility within Stock Loan for its operational practices and for the Department's WSPs, which WSPs were incorporated into Penson's WSPs. **The Senior Vice President of Stock Loan knew that Rule 204T(a)/204(a) required Penson to close out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Senior Vice**

**President of Stock Loan knew Penson was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities.**

(See Order on Stipulations; Hearing-Day 10, 2427:15-2428:4, Nov. 7, 2014)

54. As head of PFSI Stock Loan, Mike Johnson **ultimately made the decision** that Stock Loan would not close-out fails to deliver until the afternoon of T+6.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Wetzig testified that Mike Johnson developed the procedure by which PFSI would not close-out until the afternoon of T+6.
- c. Support:
  - DeLaSierra Testimony

Q I want to take a little bit of a tangent and just ask you if Stock Lending had bought in on the Penson's own propriety account on the morning of T+6, is that something you think you would have had authority to do?

A I would not have, no.

Q Why not?

**A: Well, now you're taking proprietary positions and illiquid names, and that would have had to have been approved above me, probably above Mike Johnson.**

...

Q Okay. And why would Penson buy in on their own propriety account?

A If they wanted to be long of security.

Q Okay. And how -- sorry. How does that fit in with Rule 204?

A It doesn't.

Q Okay. Would that be a -- a PFSI activity though --

A It would --

Q -- something your group would handle?

A It would be PFSI.

**Q Okay. I think you said that that approval for that activity might have to go above -- above Mike Johnson --**

**A Yes.**

**Q -- I believe is what you said? In fact, Phil would have to approve that activity, right?**

**A You would probably go to Phil.**

(Hearing – Day 1, 228:6-15, 307:7-25, Oct. 27, 2014)

- Wetzig Testimony

Q So who developed Stock Loan's practices and procedures for closing out 204 -- for closing out long sales of loan securities for 204 purposes?

A From my knowledge, it would be Mike Johnson.

Q And the practice then was -- was Rudy De La Sierra or Mike or Brian Hall ever -- do you know if they had any role in it?

A Maybe a minimal role at the end of the day. Mike was the guy in charge and the guy who ultimately told us what to do.

Q **So Mike Johnson developed the procedure by which you would not close-out until afternoon of T+6?**

A **Correct.**

(Hearing- Day 2, 389:11-389:23, Oct. 28, 2014)

55. One of the pressure points in PFSI's relationships with its counterparties was around being bought in, because it could be a cost for the counterparty.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Wetzig testified that** one of the pressure points in PFSI's relationships with its counterparties was around being bought in, because it could be a cost for the counterparty.
- c. Support:
  - Wetzig Testimony

Q Mr. Wetzig, when you were at Stock Lending, at Penson Financial Services, did you observe any pressure points on those relationships with other broker-dealers?

A I did.

Q What were those pressure points?

A More so on when we were trying to buy them out.

Q What do you mean by that? Explain why buying --

A So --

Q -- would be a pressure point.

A -- we would recall the stock that we were loaning them, and they would essentially push back quite a bit when we tried to buy them out on that loan that they were not returning.

Q Did they tell you why they were pushing back on a buy-in?

A Normally, it was because their customer had already covered the trade.

Q And why -- just help us understand. Why would a broker-dealer care if you were buying them in?

A Because they had a client on the other side of that trade. So if they -- if you essentially buy-in a broker-dealer, you're closing out their customer's trade --

Q Is there --

A -- or the --

Q I'm sorry. I didn't mean to talk over you. I was going to ask, is there cost to that broker-dealer, of you buying them in?

A That would depend if they could -- if their customer had not covered the trade amount, they could just pass the price directly to the customer. If the trade has already been closed out, that broker would be -- or the customer would be long in the shares once they got bought in.

(Hearing- Day 2, 358:9-359:18, Oct. 28, 2014)

56. Maintaining relationships with PFSI's counterparties was extremely important to PFSI's business model. Without those relationships, PFSI would likely have gone out of business.

- a. Response: **Dispute** – accuracy of statement. The Division's statement mischaracterizes the nature and scope of the testimony.
- b. Counterstatement: **Wetzig testified that** maintaining relationships with PFSI's counterparties was extremely important. **He testified that** without those relationships, PFSI would not have been able to cover trades, borrow securities, or loan securities to make revenue, which **he assumed would cause** PFSI to go out of business.
- c. Support:
  - Wetzig Testimony

Q Earlier, when you were discussing the mechanics of Stock Lending and who you would loan or borrow shares from, I thought I heard you say something like there were -- there were big guys like Citigroup. Do you recall that?

A I do.

Q Help us understand what that means. Where did Penson fit in the world of broker-dealers, and was it a big guy, small guy?

A So while we were considered big by clearing firm standards, we were kind of an asset size, a lot smaller than, obviously, the Citigroups and Goldman Sachs and the Ameritrades and those types of broker-dealers that we were doing business with.

Q **Were the relationships with those broker-dealers important to Penson Stock Lending?**

A **They were extremely important.**

Q Why?

A If we did not have those relationships, we could not go out and borrow. We could not borrow or lend securities to perform stock lending.

Q Why not?

A If we couldn't go out to -- they could essentially quit doing business with us and shut us off.

(Hearing- Day 2, 357:10-358:8, Oct. 28, 2014)

Q You may have said this, and I apologize: **But if Penson Financial Services didn't have these relationships with the broker-dealer, what -- what would happen?**

A We probably would have -- we wouldn't have been able -- we wouldn't have been able to cover trades. We wouldn't have been able to borrow securities. **We wouldn't have been able to loan to make revenue. So at some point, I would assume that the firm would have gone out of business.**

(Hearing- Day 2, 360:13-360:22, Oct. 28, 2014)

57. Nothing in Rule 204T or Rule 204 allowed PFSI to delay its close-out until the end of the day on T+6 based on the terms of PFSI's recall letter or the terms of the MSLA.

- a. Response: *Dispute* – accuracy of statement. The Division's statement mischaracterizes the nature and scope of the testimony and calls for a legal conclusion.
- b. Counterstatement: De La Sierra testified that, to his knowledge, nothing in Rule 204T or Rule 204 **stated that** PFSI **could** delay its close-out until the end of the day on T+6 based on the terms of PFSI's recall letter.
- c. Support:
  - De La Sierra Testimony

Q You talked about the **recall letters** stating that they had all day on T6. Was there anything in the rule that said that, **to your knowledge**?

A No.

(Hearing- Day 1, 227:1-227:4, Oct. 27, 2014)

58. The MSLA and PFSI's recall letter were specific to the date the recall was issued, rather than the date the trade was executed, meaning that if a recall was issued on, for example, T+2, the borrower would have three full business days, or until the end of the day on T+5, to return the shares.

- a. Response: *Dispute* – accuracy of statement and unclear as stated.
- b. Counterstatement: Pursuant to the MSLA and PFSI's standard recall letter, the date on which PFSI was permitted to buy in a customer was specifically tied to the date PFSI issued a recall notice as opposed to the trade execution date, meaning that if PFSI issued a recall notice on, for example, T+2, the borrower would have three full business days, or until the end of the day on T+5, to return the shares.
- c. Support:
  - Wetzig Testimony

Q Now, I want to make sure something is clear for the record. The MSLA that you're talking about, does it talk about on what T date you can close-out a loan or is it specific to when you issued the recall?

A It is specific to when you issue the recall.

Q So hypothetically, help us understand this. If Penson had issued a recall on T+1, when could -- under the Master Securities Lending Agreement, when could you buy-in a customer?

A On T+4, if we would have issued on T+1.

Q All right. And the same thing, if Penson had issued the recall on T+2, when could it have

recalled -- bought in a customer?

A We could bought in a customer on T+5.

(Hearing- Day 2, 369:7-369:20, Oct. 28, 2014)

59. In approximately the fall of 2011, Stock Loan became aware of a provision in Rule 204's adopting release that **suggested that compliance with Rule 204 could be achieved by issuing recalls of loaned stock on T+2.**

- a. Response: *Dispute* – accuracy of statement. The Division's statement mischaracterizes the nature and scope of the testimony. The Division's statement regarding Rule 204 compliance is unsupported by testimony of its own expert witness.
- b. Counterstatement: De La Sierra testified that, in approximately the fall of 2011, Stock Loan became aware of **footnote 55** of Rule 204's adopting release.
- c. Support:
  - De La Sierra Testimony

Q ... What did Stock Lending do in the fall of 2011?

A **Once we became aware of the Footnote 55**, we started working with Sendero to -- to have some visibility into future settlement. That way we could accurately send recalls out on T2.

(Hearing- Day 1, 247:19-247:24, Oct. 27, 2014)

- Harris Testimony

Q My question was, it is a violation if you do not recall on T+2; is that a true or false statement?

A It is a violation if you do not -- that's a false -- I hate these negatives, the double negative stuff. Let me just --

Q I'm happy for you to rephrase it in a way that it makes sense.

A As I stated before, **the rule does not require that you recall on T+2. Accordingly, if you don't recall on T+2, you haven't violated any rule.**

Q **Did you hear testimony during this trial from some witnesses who believed that the rule was you must recall on T+2?**

A **Yes, I did.**

Q **Did that surprise you?**

A **I recognized that it was mistaken.**

Q It was confused?

A **No. I recognized that the witness was mistaken.**

(Hearing-Day 4, 1115:2-20, Oct. 30, 2014)

60. At that time, Stock Loan reprogrammed its Sendero system to issue recalls on T+2, **which allowed it to comply with both Rule 204 and the MSLA.** By recalling on T+2, Stock Loan could buy-in a counterparty three days after the recall, or at the close of business on T+5, and still close-out the fail to deliver before market-open T+6. The re-programmed system was extremely accurate in allowing Stock Loan to recall shares that were going to be in a fail position.

- a. Response: *Dispute* – accuracy of statement. The Division’s statement mischaracterizes the nature and scope of the testimony. The Division’s statement regarding Rule 204 compliance is unsupported by testimony. Contradicting testimony provided by Harris.
- b. Counterstatement: De La Sierra and Wetzig testified that in the fall of 2011 Stock Loan reprogrammed its Sendero system to issue recalls on T+2. **Stock Loan believed that if they recalled on T+2 it would cure the conflict between Rule 204 and the MLSA.** By recalling on T+2, Stock Loan could buy-in a counterparty three days after the recall, or at the close of business on T+5, and still close-out the fail to deliver before market-open T+6.. The re-programmed system was extremely accurate in allowing Stock Loan to recall shares that were going to be in a fail position.
- c. Support:
  - Harris Testimony

Q My question was, it is a violation if you do not recall on T+2; is that a true or false statement?

A It is a violation if you do not -- that's a false -- I hate these negatives, the double negative stuff. Let me just --

Q I'm happy for you to rephrase it in a way that it makes sense.

A As I stated before, **the rule does not require that you recall on T+2. Accordingly, if you don't recall on T+2, you haven't violated any rule.**

Q **Did you hear testimony during this trial from some witnesses who believed that the rule was you must recall on T+2?**

A Yes, I did.

Q **Did that surprise you?**

A **I recognized that it was mistaken.**

Q It was confused?

A No. I recognized that the witness was mistaken.

(Hearing-Day 4, 1115:2-20, Oct. 30, 2014)

- De La Sierra Testimony

Q At some point in time, did Penson Stock Lending do anything to begin recalling on T+2?

A Yes, we did.

Q Describe that process for us. When did that occur?

A It would have been in the fall of 2011.

...

Q ... What did Stock Lending do in the fall of 2011?

A Once **we became aware of the Footnote 55**, we started working with Sendero to -- to have some visibility into future settlement. That way **we could accurately send recalls out on T2**.

Q And -- and was Stock Lending able to reprogram Sendero to have visibility into future settlements?

A Yes.

Q How accurate was it?

A It was extremely accurate. From all our testing, most of the -- the fails that occurred from that were -- were not accurate, were not legitimate. They were based on a glitch. But we were recalling our -- for our fails on -- very accurately.

(Hearing- Day 1, 247:5-248:9, Oct. 27, 2014)

Q ... **I think you also said that recalling on T2 enabled Pension to do recalls and handle the tensions with the Master Securities Lending Agreement.** Am I summarizing accurately?

A That's correct.

Q Explain that, just so we understand.

A So by recalling on T2, **now we were within the timelines of our recall letter**. We could close -- we could close-out the security at the afternoon of T5 or, if need be, open it as T6 and -- because our counterparties would accept these buy-ins.

(Hearing- Day 2, 333:8-333:20, Oct. 28, 2014)

- Wetzig Testimony

Q Did there ever come a point in time where Sendero was reprogrammed to change when that recall was happening?

A Yes.

(Hearing- Day 2, 372:25-373:3, Oct. 28, 2014)

Q Do you recall how the reprogramming worked? I mean, what happened? What -- what did you do to reprogram Sendero?

A So our programmer, Matt Battaini, **programmed Sendero so that we could see what we needed to recall on T+2 instead of T+3**.

(Hearing- Day 2, 373:7-373:12, Oct. 28, 2014)

Q Now, once Sendero was reprogrammed to recall on T+2, did you still have issues with your counterparties pushing back and citing the MSLA?

A Very little.

Q And -- and why was that? Why did that resolve that problem?

A Now that we were recalling on T2, we could buy-in at the end of the day T5.



(Hearing- Day 2, 374:21-375:3, Oct. 28, 2014)

61. The reprogramming of Sendero was done in house, and took approximately one week.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Wetzig recalled** the reprogramming of Sendero was done in house, and took approximately one week.
- c. Support:
  - Wetzig Testimony

Q Mr. Wetzig, did you have an understanding of how Sendero was reprogrammed?

A Yes, I did.

Q How did you gain that understanding?

A Our programmer, Matt Battaini, who worked with us in Stock Loans. It was known that he programmed Sendero so that we could see what we needed to recall on T+2.

Q All right. **Do you recall how long it took Matt, Mr. Battaini, to reprogram Sendero?**

A **It wasn't very long. I would say, maybe, a week.**

(Hearing- Day 2, 373:25-374:11, Oct. 28, 2014)

62. No one from compliance alerted Stock Loan to the provision in Rule 204's adopting release that suggested issuing recalls on T+2.

- a. Response: **Dispute** – misleading and inaccurate statement; contrary testimony.
- b. Counterstatement: The Compliance department gave sufficient guidance to Stock Loan on how to comply with Rule 204. Rule 204 does not require recalls on T+2 and a failure to recall on T+2 does not violate Rule 204.
- c. Support:
  - Harris Testimony

Q My question was, it is a violation if you do not recall on T+2; is that a true or false statement?

A It is a violation if you do not -- that's a false -- I hate these negatives, the double negative stuff. Let me just --

Q I'm happy for you to rephrase it in a way that it makes sense.

A As I stated before, **the rule does not require that you recall on T+2. Accordingly, if you don't recall on T+2, you haven't violated any rule.**

Q **Did you hear testimony during this trial from some witnesses who believed that the rule was you must recall on T+2?**

**A Yes, I did.**

**Q Did that surprise you?**

**A I recognized that it was mistaken.**

**Q It was confused?**

**A No. I recognized that the witness was mistaken.**

(Hearing-Day 4, 1115:2-20, Oct. 30, 2014)

- Stip. FOF 59 (“For the alleged violations of Rule 204 for long sales of loaned securities in this case, the Division of Enforcement is not alleging that a failure to recall on T+2 or failure to close out at any time prior to market open of T+6 is a violation”).
- Ex. 348 (Delaney circulated Rule 204 notice and analysis)

From: Tom Delaney  
Sent: Mon 8/10/2009 3:30:51 PM  
Importance: Normal  
Subject: Adoption of Reg SHO Rule 204.  
MAIL\_RECEIVED: Mon 8/10/2009 3:30:51 PM

All-

I wanted to send you all a quick note to reinforce recent SEC action with respect to short sales. On July 27, the SEC adopted Rule 204 of Regulation SHO (previously known as 204(t)), making permanent the interim rule imposing close-out requirements on short sales. As adopted, Rule 204 requires that broker-dealers close out most fail positions at the beginning of the first settlement day following the Settlement Date, generally T+4. Broker-dealers that do not close out fail positions in accordance with Rule 204 become subject to a "borrowing penalty" until the broker-dealer purchases securities to close out the fail position and the purchase clears and settles at a registered clearing agency.

A broker-dealer has until the third settlement day following settlement date (T+6) to close out the fail position without becoming subject to the borrowing penalty if: (1) the broker-dealer can demonstrate on its books and records that a fail position resulted from a long sale; or (2) the fail position is attributable to bona fide market-making activities by registered market makers, options market makers, or other market makers obligated to quote in the over-the-counter market.

The final rule did include some modifications from 204(t). Specifically:

(1) **Early Close Outs Using Pre-Fail Credits.** Rule 204 continues to permit early close outs through the use of so called "Pre-Fail Credits." However, Rule 204 now provides that a broker-dealer may use either purchases or borrows to obtain the Pre-Fail Credits, rather than being limited to purchases. In addition, Rule 204 provides that a broker-dealer is only required to obtain Pre-Fail Credits to cover its open fail position, rather than having to cover the entire amount of its open short position;

(2) **Using Borrowed Shares to Close Out Fail Positions.** As noted above, Rule 204 continues to allow broker-dealers until T+6 to close out a fail position without becoming subject to the borrowing penalty if the fail position results from long sales or from bona fide market

making activity. However, broker-dealers now may either borrow or purchase securities to close out those fail positions, rather than being limited to purchases;

(3) **Allowing Extended Close Out Period for All “Deemed to Own” Securities.** Rule 204 incorporates the provision of Rule 204T stating that fail positions resulting from sales of securities pursuant to Rule 144 under the Securities Act of 1933 must be closed out by no later than the beginning of regular trading hours on the 35th consecutive calendar day following Settlement Date. However, Rule 204 extends the application of that time frame beyond Rule 144 securities to all securities that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed; and

(4) **Explicit Prohibition on Sham Close Outs.** Rule 204 now includes specific language to provide that a broker-dealer will not be deemed to have fulfilled the requirements of Rule 204 where the broker-dealer enters into an arrangement with another person to purchase or borrow securities as required by Rule 204, and the broker-dealer knows or has reason to know that the other person will not deliver securities to settle the purchase or borrow.

Please feel free to distribute among team members as appropriate. If you have any questions or comments, please do not hesitate to call me.

Thanks,

Tom



Thomas R. Delaney II | Senior Vice President, Chief Compliance Officer  
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- Ex. 384 (re Reg SHO training)

**To:** Tom Delaney[T] [REDACTED]@PENSON.COM]  
**Cc:** Holly [REDACTED]@PENSON.COM]  
**From:** Doug Gorenflo  
**Sent:** Fri 7/9/2010 3:44:53 PM  
**Importance:** Normal  
**Subject:** RE: Reminder: Upcoming Webinars  
**MAIL\_RECEIVED:** Fri 7/9/2010 3:44:53 PM

Please let me know if you have any additions, but I think that the following should be in attendance:

Brian Gover

Summer Poldrack (Buy-ins)

Angel Beeson (Buy-ins)

Tracie Pittman (Buy-ins)

Craig Hughes (Buy-ins)

Brandon Carter (Buy-ins)

Brian Hall & whoever he wants to bring from Stock Loan

Jimmy Glasgow, Jeff Wilhelm & whoever they want to bring from Trading

Todd Boppell

Doug Gorenflo

Senior Compliance Officer, AML Manager

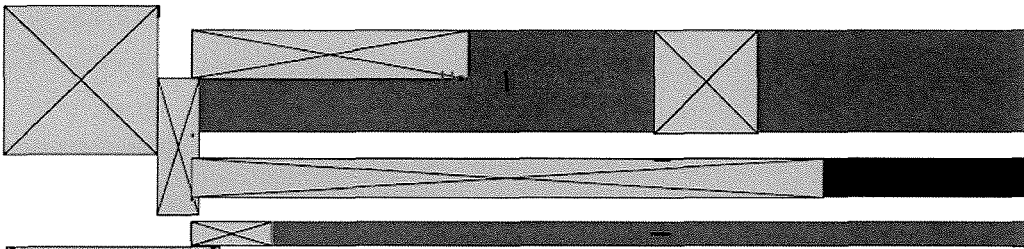
**From:** Tom Delaney  
**Sent:** Friday, July 09, 2010 10:33 AM  
**To:** Doug Gorenflo  
**Cc:** Holly Hasty  
**Subject:** FW: Reminder: Upcoming Webinars

Do you want to see if you can get a training center room and invite key participants to participate in the Reg-SHO training?

Delaney Ex

- Ex. 397 (forwarding tips on fails to deliver)

**From:** Tom Delaney  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=TDELANEY>  
**Sent:** Sunday, September 21, 2008 7:45 PM  
**To:** Bill Yancey  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=BYancey>; Phil Pendergraft  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=PPenderg>; John Kenny </O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=JKenny>; Mike Johnson  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=Mjohnson52269396>  
**Subject:** SEC "tips" on avoiding failures to deliver...



## Regulators Provide "Tips" for Broker-Dealers on Avoiding Failures to Deliver Securities

The Staff of the SEC's Division of Trading and Markets and the Office of Compliance Inspections and Examinations, along with FINRA and NYSE are providing the following information to assist broker-dealer firms in preventing failures to deliver securities. Firms conducting short sales are encouraged to consider practices to prevent delivery failures, including, for example:

- Ex. 413 (regarding Rule 204 training)

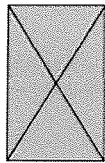
**From:** Eric Alaniz  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=EALANIZ>  
**Sent:** Thursday, June 24, 2010 3:34 PM  
**To:** Tom Delaney <[REDACTED]@PENSON.COM>  
**Subject:** Reg-Ed for Reg SHO

---

Tom,

After reviewing the description of the Reg SHO firm element training it is a perfect educational tool for any required individual. It specifically covers Rule 204 requirements to promptly purchase or borrow securities to deliver on long and short sales. This will definitely work.

Eric



**Eric Alaniz**, Compliance Officer, Compliance Department  
Penson Financial Services, Inc.

1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201

P: 214.953.3446 | F: 214.765.1242

[www.penson.com](http://www.penson.com)

*Building the Best Clearing and Execution Services Firm in the World*

- Delaney Testimony

Q: You have Exhibit 378 in your binder. Do you see that document?

A: I do.

Q: And what is that?

A: That's an e-mail from Mark Fitterman, an attorney for Morgan Lewis, sent to me on Thursday, February 10th, 2011; subject, attorney-client privileged communication, Reg SHO.

Q: If you could go back to the first e-mail in this chain. Who is that e-mail from and who is it to?

A: The first e-mail is to Andy Koslow, with a copy to Holly Hasty, from me.

Q: And if you were to look at -- **so I think two of the last three paragraphs there, the second-to-last and third-to-last paragraphs, does that -- does that describe this dispute that you had with Mr. Johnson?**

A: The last three? It that what you said?

Q: Yeah, on Page 3 of this document. Does that describe the dispute?

A: Yes. I think that describes the dispute, yes.

Q: And accurately, as far as you're concerned?

A: Yes.

**Q: All right. And you sent that to Mr. Koslow, the general counsel?**

**A: I did.**

**Q: And then did you send it on after that to the attorneys at Morgan Lewis?**

**A: I did.**

(Hearing – Day 5, 1310:4-1311:6, Oct. 31, 2014)

- Alaniz Testimony

Q . . . All right. Now, you went over this quickly with Ms. Atkinson, but when you first met with Stock Loan, who was there?

A Rudy De La Sierra and Brian Hall.

Q Okay. And in the first meeting with them, did you discuss the rule?

A I discussed my interpretation of the rule.

Q And what did you tell them that you – you understood the rule to require?

**A I understood the rule to require if there were any fails of T+4 or T+6, that the position in question must be bought in at -- prior or at market open.**

Q Okay. I don't want to belabor it too much, but fails would be a situation where there was -- a security was supposed to be delivered to CNS --

A Correct.

Q -- and for whatever reason, it wasn't?

A Correct.

Q And had to be bought in? Or was buying in the only way to cure a fail, to the best of your recollection?

A Buy in borrow the shares.

Q Okay. And you told them that needed to be done at or prior to market open on T+6 or T+4; is that correct?

A Correct.

Q And T+4 deals with short sales?

A Correct.

Q T+6 the long sales?

A Correct.

Q Okay. Did they -- and I guess you can talk about them individually or as a group. Did either of them mention to you a different interpretation?

A No, they did not. Brian Hall was silent. Rudy De La Sierra indicated that that was not his interpretation of the rule.

Q Okay. What did he tell you his interpretation was?



A He did not. He just stated that my interpretation was not the correct interpretation. So at that point, so there wouldn't be any, I guess, head butting or trying to, I guess, to avoid any type of confusion, I let them take the rule with them. I told them to read it, sleep on it, and the next day we would reconvene and we would decided what -- what they thought the understanding of the rule was.

Q Okay. So did that happen?

A Yes.

Q That next day meeting, what happened?

A The next morning, I was called up. I can't remember who called me up. I met with Brian Hall, Rudy De La Sierra, and they brought in Matt Butane and I went over with Doug Gorenflo. And as soon as we arrived, I asked them if they had time to read the rule. **And they said yes, and they did confirm that my interpretation of the rule was correct.**

Q Okay. At any point during that meeting, did they tell you that they -- that their operations were inconsistent with your interpretation of the rule?

A No.

(Hearing – Day 3, 750:5-752:14, Oct, 29, 2014)

- Stip. FOF 70 (“Members of Pension’s Stock Loan Department at all times knew that Rule 204T or 204 required them to close out all long sale transactions by market open at or before market open on T+6”).

63. Delaney told conflicting stories about his knowledge and conduct in this case.

- Response: **Dispute** – accuracy of statement. The Division’s statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- Counterstatement: Delaney’s testimony has been consistent with honest recollection of events informed by increasing preparation, review of contemporaneous documents, and greater understanding of the questions asked.
- Support: *See* responses below. *See also* Delaney’s Response to Division’s FOF 63.

a. For instance, Delaney originally testified that he never knew about Stock Loan’s practice of Rule 204 violations. Next, he admitted in his Wells submission that he knew Rule 204 close out issues might begin with Stock Loan. Finally, Delaney testified that he did learn of Stock Loan’s practice of Rule 204 violations, but only when he saw the March 2011 letter to FINRA disclosing Stock Loans’ violations to regulators.

- Response: **Dispute** – accuracy of the statement; contrary evidence in record; not supported by Division’s citations to the record. Reliance on Wells submission is misplaced. Division’s statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- Counterstatement: Delaney was not aware of Stock Loan’s Rule 204 violations until March 2011. His trial testimony is consistent with his investigative testimony.

- Support:
  - See Court Order, Admin. Proc. Rulings Release No. 2220 (Jan. 15, 2015) (“Jan. 15, 2015 Order”) (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).
  - Delaney Testimony

Q: Prior to you seeing that FINRA exam response that we showed in Exhibit 89 a moment ago, had you ever had a conversation with anyone at Penson that left you with the understanding that Stock Loan wasn't closing out long sales of securities they had out on loan?

A No.

(Hearing-Day 5, Delaney, 1307:9-14, Oct. 31, 2014)

- Johnson Testimony

Q And let me ask you generally, and then we'll talk specifically. Was Mr. Delaney aware that those practices we just saw in Exhibit 89 were how Stock Loan was operated?

A I don't know.

(Hearing-Day 2, Johnson, 517:19-23, Oct. 28, 2014)

- Exhibit 224 (Delaney Investigative Testimony) at pp. 90, 139

Q Were you aware of any systemic or policy level decisions from the stock loan group that were contrary to the requirement to close out fails to deliver on long sales by the open market T plus 6?

A Not systemic, no, sir.

(Delaney, Tom- INV vol I, 90:12-90:16, Apr. 4, 2012)

Q My question is for the stock loan department. During the time that you were the CCO of Penson Worldwide or PFSI, were you aware that the stock loan department had a policy of closing out Rule 204 close-outs after market?

A I was not aware of that.

(Delaney, Tom- INV vol I, 139:23-140:2, Apr. 4, 2012)

- Exhibit 224 (Delaney Investigative Testimony) at pp. 489 – 490

Okay. **So was it in the course of drafting this March 2011 letter to FINRA that you first learned that as a matter of practice Stock Loan group was not closing out fails-to-deliver of**

**long sales in accordance with Rule 204A?**

**A** It was in the process of making that response. Drafting the letter may have taken a couple of days. There would have been stuff in front of that. It could have been a couple of days but it was around -- generally around that time that I -- that I recall learning of this.

(Delaney, Tom- INV vol III, 489:22-490:5, July 31, 2013)

- See also Delaney's Response to Division's FOF 63a.

b. In addition, Delaney told conflicting stories about the March 2011 letter to FINRA (Exhibit 89), which finally disclosed Stock Loan's Rule 204 violations to regulators. In his original testimony he said that he did not recall being concerned about the disclosure. In contrast, he later testified that the disclosure was a big deal, and that the Compliance department was greatly alarmed by the disclosure.

- Response: **Dispute** – accuracy of the statement; contrary evidence in record; not supported by Division's citations to the record. The Division's statement also constitutes impermissible argument. See Post-Hearing Order ¶ 5(c).
- Counterstatement: Delaney was not aware of Stock Loan's Rule 204 violations until March 2011. He testified consistently that he felt he had an obligation to disclose the practice to the regulators.
- Support:

**A** This was clearly -- this was clearly a -- a moment where the firm was self-reporting something that we in the Compliance department had had an understanding -- had -- that this activity was not occurring. So this was -- this was new information when we were being told that we were in compliance with this rule, **and we were now disclosing this to our regulator.**

**Q** And did it cause you any concern that you were disclosing it to your regulator?

**A** I don't know if it's concern that you're disclosing it to a regulator. At the end, you -- if this is what you do, and **it's responsive to the regulator's query, that's -- that's what you do. You -- you tell the truth. You put it in there, and then you just deal with the consequences after.**

(Delaney, 1297:22-1298:11, Oct. 31, 2014)

See also Delaney's Response to Division's FOF 63b.

c. Delaney also told conflicting stories about his escalation of Stock Loan's Rule 204 violations to Yancey. He originally testified that he did not escalate the issue to Yancey. Next, in his Wells submission, he claimed that he raised the issue with Yancey "many times – both routinely and extraordinarily." Finally he testified, again, that he did not tell Yancey about Stock Loan's violations, even as he was authorizing disclosure of those violations to be made to regulators.

- Response: **Dispute** – accuracy of the statement; contrary evidence in record; not supported by Division's citations to the record. The Division's statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- Counterstatement: Delaney has testified consistently he never told Yancey of any Rule 204(a) violations by Stock Loan regarding long sales of loaned securities.
- Support:
- Stip. FOF 43 (Yancey was not aware that Pension's Stock Loan Department was violating Rule 204).
- Exhibit 224 (Delaney Investigative Testimony) at p. 270

Q Do you know was Mr. Yancey aware that Pension was executing long sales at the conclusion of the DTCC trading window at approximately 3 Eastern Time instead of the open market?

A I don't know what Mr. Yancey knew or didn't know.

Q Did you ever escalate that issue to him?

A **Not specifically. I don't recall specifically escalating this particular issue.**

(Delaney, Tom- INV vol II, 270:15-270:23, Aug. 29, 2012)

64. Delaney attempted to repudiate admissions made by him in his Wells submission.

- General Response: **Dispute**. This proposed finding of fact is conclusory, contains impermissible argument, and is unsubstantiated. *See* objections and responses to subparts below. *See also* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).

a. For instance, after saying that he understood a Wells submission to be, "a response to an invitation by the SEC to -- to respond to a -- their intent to file a lawsuit," he said, "I believe my lawyers crafted a -- a response -- and I don't know what they -- I don't know what their -- what their purpose was at that point in time."

- Response: **Dispute** – impermissible argument.

b. Delaney admitted that he reviewed his Wells submission before it was sent to the Commission and approved it being sent on his behalf.

- Response: **Dispute** – impermissible argument.

c. Although Delaney admitted reading his Wells submission and approving its submission, he disclaimed the admissions made therein.

- Response: **Dispute**. The finding of fact constitutes impermissible argument and is not supported by the record.
- Counterstatement: Delaney testified that the Wells Submission was made with limited information and that he later became privy to more information that provided further context.
- Support:
- Delaney Testimony

Q And did you see anything in the final Wells submission that you felt was incorrect or untrue? Well, let me ask it this way: If you saw something in the Wells submission that you knew to be incorrect or untrue, you would have brought that to the attention of your lawyers, I presume; isn't that right?

A **I think the challenge was, for me in particular, my attorneys having drafted the document really with a lot of limited information. I have since been privy to tons of information to be able to put context to things.**

(Hearing- Day 5, 1409:7-1409:17, Oct. 31, 2014)

- *See also* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).

d. Delaney even tried to distance himself from admissions in his Wells submission as to things he, himself, had supposedly said or done, saying, “it was prepared by my attorneys. I read it. I signed it. I counted on my -- relied on my attorneys to do a competent job.”

- Response: **Dispute** – accuracy of statement. Additionally, the Division’s finding of fact contains impermissible argumentative in violation of the Court’s Post-Hearing Order. *See also* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).
- Counterstatement: Delaney testified that his Wells statement was prepared by his attorneys and that he read and signed the document.
- Support:

- Delaney Testimony

Q Okay. So can we agree, at least as to the things that you did and the things that you said, that if there was anything in this document that was untrue, that you would have brought that to the attention of your counsel?

A I may -- again, this was -- this was really -- it was just -- **it was prepared by my attorneys. I read it. I signed it.** I counted on my -- relied on my attorneys to do a competent job.

(Hearing- Day 5, 1410:12-1410:20, Oct. 31, 2014)

e. Finally, however, Delaney was forced to admit that he could not repudiate admissions concerning his own actions and words.

- Response: **Dispute** - impermissible argument.
- Counterstatement: Delaney testified that after he read and reviewed his Wells submission it was sent to the Commission.
- Support:
- Delaney Testimony

BY MS. ATKINSON: **Q After you read and reviewed this document, it was left in the document that went to the Securities and Exchange Commission, isn't that true?**

**A Yes, ma'am.**

(Hearing-Day 5, 1413:3-1414:1, Oct. 31, 2014)

- *See also* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).

65. Delaney was evasive in his testimony at the hearing in this matter. For instance:

- Response: **Dispute**. The Division's statement is not supported by the cited testimony and constitutes impermissible argument. *See* responses and objections to subparts 65(a) – (c).

a. **Despite the clear language in Ex. 89, and later stipulations by his counsel, Delaney denied** that it was the practice of PFSI's Stock Loan department to closeout long sales at market close rather than market open.

- Response: **Dispute** – accuracy of statement. The Division's statement is not supported by the record and constitutes impermissible argument. *See* Post-Hearing Order.
- Counterstatement: Delaney testified that he was unaware of whether it was PFSI's Stock Loan department's practice to closeout long sales at market close rather than market open.
- Support:
- Delaney Testimony

Q And if you look at the next page, Page 32 of 38. If you look at the second paragraph at the top of the page, that section says, "With regards to the timing of long-sales closeouts, the Firm does not believe it is industry practice to close-out long sales prior to the market open on T+6. Not once has the Firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the Firm's borrowing counterparties will not accept a closed out price on a stock loan at the market open. Thus, the Firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced."

Do you see where I was reading?

A Yes, ma'am.

Q And you would agree with me that that was the practice of Penson's Stock Loan department from late 2008 through 2011; isn't that right?

A **I don't know if I would agree that I know that's the practice.** What that was, was a draft that had been presented to me by the subject matter experts --

Q Mr. Delaney?

A -- responsible for that.

(Hearing- Day 2, 571:22-572:19, Oct. 28, 2014)

b. **Despite having previously testified that he read the release for Rule 204T, at the hearing Delaney quibbled** about whether he had seen the release in the same exact format as that in the exhibit used at the hearing and during his testimony.

- Response: **Dispute** – accuracy of statement. The Division's statement is not supported by the record and constitutes impermissible argument. *See* Post-Hearing Order.
- Counterstatement: Delaney did not dispute that he had seen the adopting release of Rule 204T.
- Support:
- Delaney Testimony

Q So you've seen Exhibit 67. You've seen the adopting release for Rule 204T; is that correct?

A I said that here, but I stand my by answer that I think my intention was that **I don't know if I specifically saw it off the Federal Register. But I certainly would have seen it in some other context of the rules being released.**

(Hearing-Day 2, 576:12-18, Oct. 28, 2014)

c. Although ultimately admitting that there was only one test of Stock Loan's Rule 204 procedures, Delaney originally denied that fact.

- Response: *Dispute* – accuracy of statement. The Division's statement is not supported by the record and constitutes impermissible argument. *See* Post-Hearing Order.
- Counterstatement: Delaney explained that **he did not know** whether there was other testing of Stock Loan's Rule 204 compliance.
- Support:
- Delaney Testimony

Q In fact, Mr. Delaney, the test in December of 2009 is the only test that tested Stock Loan's compliance with Rule 204; isn't that right?

A **I don't know that.**

Q Do you know of any other testing as you sit here today that tested Stock Loan's compliance with Rule 204?

A That was a long time ago. There may have been a lot of testing in the quality control that was going on.

Q **As you sit here today, do you know of any other testing that showed that stock -- Stock Loan's compliance with Rule 204?** It's just yes or no. Yes, you do know, or no, you don't know.

A As I -- **right now in my present recollection, I don't know.**

Q Okay. I think you testified yesterday that you, over the course of preparing for this case, have looked at thousands of documents. Is that what you said?

A I don't know if I said thousands, but it may have been hundreds.

Q Lots and lots of documents?

A Lots of documents.

Q Did you see anything in those documents that showed any other testing of Stock Loan's Rule 204 compliance?

A I may have.

Q Do you remember seeing any documents that showed that?

A **As I sit here today, I don't have a recollection of any other testing.**

Q Okay. Do you think if there was other testing, your counsel would have brought that to your attention?

A I don't know what my counsel would do.

(Hearing- Day 3, 637:3-638:11, Oct. 29, 2014)



66. Delaney is associated with a registered broker-dealer.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 1 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 1 as set forth below.
- c. Support:
  - Stip. FOF 1

FOF 1.	Delaney, 45, of Colleyville, Texas, was the CCO at Penson from at least October 2008 through April 2011. Delaney currently works in compliance at a registered broker-dealer. He holds Series 4, 7, 24, 27, 53, and 63 licenses.
--------	--

(See Order on Stipulations; Hearing-Day10, 2287:20-23, Nov. 7, 2014)
--

67. PFSI violated Rule 204T/204.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 49 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 49 as set forth below.
- c. Support:
  - Stip. FOF 49

FOF 49.	During the relevant time period there were at least 1,500 Rule 204T(a)/204(a) violations by PFSI relating to long sales of loaned securities.
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(See Order on Stipulations; Hearing-Day 10, 2468:25-2469:4, Nov. 7, 2014)
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68. Delaney was Penson's CCO when Rule 204T was implemented in September 2008.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 12 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 12 as set forth below.
- c. Support:
  - Stip. FOF 12

FOF 12. **Delaney was Penson's CCO when Rule 204T was implemented in September 2008.** He continued in that position at Penson until April 2011.

(See Order on Stipulations; Hearing-Day 10, 2319:24-2320:2, Nov. 7, 2014)

69. Delaney participated in Penson's efforts to implement procedures in response to Rule 204T in October 2008 and to Rule 204 in July 2009. Delaney knew at all relevant times that Rule 204T/204 required Penson to close-out CNS failures to deliver resulting from long sales by market open T+6.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 14 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 14 as set forth below.
- c. Support:
  - Stip. FOF 14

FOF 14. Delaney participated in Penson's efforts to implement procedures in response to Rule 204T in October 2008 and to Rule 204 in July 2009. Delaney knew at all relevant times that Rule 204T/204 required Penson to close out CNS failures to deliver resulting from long sales by market open T+6.

(See Order on Stipulations; Hearing-Day 10, 2321:7-10, Nov. 7, 2014)

70. When a new rule, such as Rule 204T or Rule 204, is adopted, the Chief Compliance Officer is responsible for designing a program for complying with the rule.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey testified that** when a new rule, such as Rule 204T or Rule 204, is adopted, the Chief Compliance Officer **and his staff are** responsible for designing a program for complying with the rule.
- c. Support:
  - Yancey Testimony

Q When a new rule is adopted such as Rule 204T or when it comes further, in the case of 204, who at Penson is responsible for designing a program for complying with the rule?

A The Compliance Chief.

Q Anyone else?

A And his -- **and his staff.**

(Hearing- Day 7, 1868:3-1868:9, Nov. 4, 2014)

71. PFSI's Compliance department should have determined whether PFSI's policies and procedures complied with Rule 204.

- Response: **Dispute** – accuracy of statement. The Division's statement constitutes impermissible argument. *See* Post-Hearing Order.
- Counterstatement: Delaney's investigative testimony stated that he believed he would have expected a compliance officer to review Rule 204 and make determinations about whether Penson's policies and procedures complied with Rule 204.
- Support:
- Exhibit 224 (Delaney Investigative Testimony) at p. 101

Q When Rule 204 was issued in July 2009, did you have an expectation that someone in your compliance group would review the rule?

A Review the rule in general, yes.

Q And make determinations about whether Penson's policies and procedures complied with the rule?

A **I believe that would have been an expectation, yes.**

(Delaney, Tom- INV vol I, 101:18-101:24, Apr. 4, 2012)

72. If a rule is complex, it is reasonable for a registered person to consult FINRA, the SEC, or another regulator; consult interpretive guidance; and/or consult with industry groups, such as SIFMA. Then one should identify and manage the related critical control points.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Brian Gover testified that if a rule is complex, amongst other options, he might submit questions to the SROs; look for interpretive guidance; perhaps reach out to outside counsel or consult with industry groups, such as SIFMA; and identify the critical control points.
- c. Support:
  - Gover Testimony

Q Let's talk -- just let's talk for just a minute about complexity. **If a regulation is complex, what do you, as a person who has worked at a broker-dealer, what do you do about that?**

A **There's a couple of pieces.** One is getting an understanding of the regulation, so in its complexity, and you would -- for new regs, you would submit questions to your SROs. You would look for any interpretive guidance that might be out there. You would kind of read the tea leaves from AWCs that you might see firms where they're getting dinged for things. You would develop a hypothesis of here's how we believe this reg reads and how it might be implemented. **You might** reach out to outside counsel. **You might** use some of the industry groups, like

SIFMA. So in short, you leverage your resources. And then from an implementation standpoint, you -- you identify the critical control points on here, what -- what these components have to be in; and you break it down into discrete tasks that you have controls around to make sure that you're -- you're doing what you need to do.

(Hearing- Day 1, 191:23-192:19, Oct. 27, 2014)

73. Beginning in November 2008, the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted a review of PFSI's Rule 204T procedures.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 28 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 28 as set forth below.
- c. Support:
  - Stip. FOF 28

FOF 28. **Beginning in November 2008, OCIE conducted a review of Pension's Rule 204T procedures.** In October 2010, OCIE issued Pension a deficiency letter reporting that OCIE had found Rule 204T(a) violations. The findings reported to Pension in the deficiency letter included findings that Pension had violated Rule 204T in connection with short sales.

(See Order on Stipulations)

74. Delaney admits that regulators raised issues about Rule 204 closeouts for long sales. Delaney also admits that he knew, at the time regulators were raising the issue, that Rule 204 closeout issues "might begin" with Stock Loan.

- Response: **Dispute** – mischaracterization of the cited support. The cited support is unreliable and reflects statements made in Delaney's Wells Submission, not Delaney's personal admissions. *See* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses).
- Counterstatement: Delaney did not admit that regulators raised issues about Rule 204 closeouts for long sales.
- Support:
  - Exhibit 157 (Delaney Wells Submission), p. 16

For example, when asked about the close out requirements in Rules 204T and 204, Mr. Delaney knew that the close out issue might begin with Stock Lending, which was the only group at PFSI that could have direct financial incentives not to close out some sales on time, but that several other business units, including the Operations Unit and the Trading and Execution Desk, clearly had a direct role in compliance with the close-out rules.<sup>33</sup> Because of its incentives, Stock

75. Delaney admits that he knew that stock lending personnel could and did cause delays in buy-ins in that he claims that he raised that issue many times with Yancey.

- a. Response: *Dispute* – mischaracterization of the cited support. The cited support is unreliable and reflects statements made in Delaney’s Wells Submission, not Delaney’s personal admissions. *See* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses). **Based on the Court’s Order, the entire Proposed FOF should be stricken.**
- b. Support:
  - Exhibit 157 (Delaney Wells Submission), p. 30, 32

**(1) Stock Lending Personnel Were Financially Incentivized to Delay Close-outs, and They Could and Did Cause Delays in Buy-ins**

**(4) PFSI Management Ignored Failures And Did Not Support the Changes Required in PFSI’s WSPs**

All of these issues were raised many times – both routinely and extraordinarily – with Mr. Yancey, who was responsible at PFSI to deal with the issues and concerns Compliance escalated. Even though Mr. Yancey was well aware of all the challenges of complying with Rules 204T, 203, and 204 at PFSI, he did not take steps to encourage, much less require, changes to PFSI’s, and particularly Stock Lending’s, practices.

76. Delaney admits knowing that there was a “gap” between the requirements set forth in the WSPs and stock lending’s practices concerning timely buy-ins that he was “working to close.”

- a. Response: *Dispute* – mischaracterization of the cited support. The cited support is unreliable and reflects statements made in Delaney’s Wells Submission, not Delaney’s personal admissions. *See* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or

defenses). **Based on the Court's Order, the entire Proposed FOF should be stricken.**

b. Support:

- Exhibit 157 (Delaney Wells Submission) at p. 32

**Mr. Yancey's approach to compliance with Regulation SHO's rules flew in the face of his duties at PFSI and turned a blind eye to the gap that Mr. Delaney was working to close between PFSI's WSPs and Stock Lending's practices concerning timely buy-ins. There is no excuse for this failure and the consequences that it had on compliance.**

77. Delaney admits knowing that Stock Loan was having issues with compliance with Rule 204T and Rule 204.

a. Response: **Dispute** – overly broad and vague. The cited support is unreliable and reflects statements made in Delaney's Wells Submission, not Delaney's personal admissions. *See* Jan. 15, 2015 Order (finding that the Wells Submission of Respondent Delaney will not be relied on in deciding any claims or defenses). **Based on the Court's Order, the entire Proposed FOF should be stricken.**

b. Counterstatement: Delaney first became aware of Stock Loan's non-compliance with Rule 204 in March 2011.

c. Support:

Q: When did you first find out that Stock Loan had a role in closing out long sales?

A: . . . it would have been no earlier than that February or that March 2011 letter.

(Hearing-Day3, 699:24-700:18, Oct. 29, 2014)

78. Rule 204 was one of the most major rule changes during Delaney's fifteen year career.

a. Response: **No dispute.**

79. Delaney knew Rule 204 was an important Rule.

a. Response: **No dispute.**

80. Because of the push-back Stock Loan got from counterparties when it initially attempted to buy them in at market-open T+6 in order to close-out fails to deliver, Johnson and De La Sierra had discussions with Tom Delaney about the issues Stock Loan was having with complying with Rule 204.

- a. Response: **Dispute** – accuracy of statement; contrary evidence in the record.
- b. Counterstatement: Because of the push-back Stock Loan got from counterparties when it initially attempted to buy them in at market-open T+6 in order to close-out fails to deliver, Johnson and De La Sierra had discussions with Tom Delaney. **Delaney informed them that the rule was the rule and could not be changed absent Congressional action.** Delaney did not believe that these discussions indicated Stock Loan was violating Rule 204, but instead believed that the pushback demonstrated that Stock Loan was *complying* with the close out requirements of Rule 204.
- c. Support:
- De La Sierra Testimony

Q ... **As a result of the pushback** that you got from your counterparties, did Stock Lending make any decision about how it would handle buy-ins on T6?

A No. That's when my -- I started having conversations with Tom Delaney.

(Hearing- Day 1, 227:5-227:10, Oct. 27, 2014)

- Johnson Testimony

Q In those conversations, did you discuss with Mr. Delaney **resistance that Stock Lending was getting to trying to buy-in, in the morning of T6?**

A I believe so.

Q And what do you believe you discussed with Mr. Delaney on that point?

A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.

(Hearing- Day 2, 518:20-519:5, Oct. 28, 2014)

Q And when Rule 204T came out, did you have conversations with anyone at Penson about them?

A I did.

Q Okay. We'll talk about some of those conversations in detail. But for present purposes, did you ever have a conversation with Mike Johnson?

A I did.

Q What do you recall about that conversation, including the time, if you can give us your best estimate?

A It was around the time when we were communicating out the 204T requirements. Mike Johnson had expressed some concern that he was getting counter-party pushback, and -- and -- and he was just voicing his -- his concern and frustration with me about

that.

**Q Did you understand what he meant by "counter-party pushback"?**

**A I believe I understood it at the time, yes.**

Q Okay. Did you give any response?

A I did.

Q What -- what was your response?

A If -- if you know Mike Johnson personally, he's -- he's a pretty interesting character; and I think I recollect my response being something like, Mike, if you don't like the rule, you need to go to Congress and/or write your congressman.

Q Why did you say that?

**A His complaint about the rule, to me -- I had no ability to change the rule from a compliance standpoint.**

**And so, at that point, I -- I -- he was expressing some frustration, and that really -- the rule is the rule, and this is really what he -- his avenue would be to go through whatever legislative process he could in order to affect a rule change.**

....

**Q Okay. If Mr. De- -- if you had asked Mr. De La Sierra if anything had changed with this counter-party pushback, and he had said, no, would that have concerned you?**

**A No.**

**Q Why not?**

**A Because if you're following the rule, you're getting counter-party pushback.**

(Delaney, 1192:9-1193:21, 1195:5-12, Oct. 31, 2014)

81. These conversations occurred at approximately the time Rule 204T was implemented.

- Response: *Dispute* – unclear as stated.
- Counterstatement: The conversations referenced in Division's Finding of Fact 80 occurred at approximately the time Rule 204T was implemented.
- Support:
- De La Sierra Testimony

Q And you may have said this in part, and if you did, approximately when did those conversations occur?

**A Right -- right at the inception of 204T.**



Q Do you recall about when that was?

A October, I think.

Q October 2008?

(Hearing- Day 1, 237:8-237:13, Oct. 27, 2014)

- Johnson Testimony

Q Yes, sir. The conversations with Mr. Delaney that we were just discussing, do you recall, when in time, **thinking about the adoption of Rule 204**, those conversations occurred?

A I think we had conversations with Mr. Delaney and others at the inception of the -- what you just said, the -- prior to the rule becoming official, there were Saturday morning meetings, et cetera, on all of this.

(Hearing- Day 2, 520:13-520:20, Oct. 28, 2014)

Do you recall if the interpretation from Mr. Delaney was roughly around the time that the rule became a permanent rule?

A I remember putting pressure for answers. So it had to be around when the rule changed, because I was concerned about complying with the rule.

(Hearing- Day 2, 524:21-525:1, Oct. 28, 2014)

82. At the time of these conversations, Stock Lending personnel did not believe they could close-out at market-open, as required by Rule 204T, because the terms of the MSLA did not allow PFSI to buy-in the borrowing counterparty until the afternoon of the third day after the recall was issued, which, because PFSI issued recalls on T+3, meant the afternoon of T+6.

- a. Response: **Dispute** – unclear as stated; not supported by evidence cited by the Division.
- b. Counterstatement: At the time of the conversations **referenced in Division's Finding of Fact 80, DeLaSierra testified that Counterparties believed** they could not be closed out on long sales of loaned securities **until the close of T+6** under the terms of the MSLA because the MSLA did not allow PFSI to buy-in the borrowing counterparty until the afternoon of the third day after the recall was issued.
- c. Support:

- De La Sierra Testimony

Q Was there any complexity to the time of when the close-out had to happen?

A Yes.

Q Describe the complexities.

A Well, we -- Pension, and probably a majority of the street, before this rule would deal in settlement, so we would deal with T3. To -- to buy-in before the -- by the open of T6, you

would have to have some view of future settlement.

Q So help us understand what that means. If you recall on T+3, what does it mean for three days later, for T+6?

A So we would not be in a time line -- a proper time line to be able to buy morning of T6, part of the recall letter. **The recall letter when we send it out would say if it's not returned by the close of business T3, then we can close-out. By trying to buy-in the morning of T6, our counterparties were saying to us that we were in violation of the -- the letter. And also the MSLA of the standard loan agreement also gives that same time line of three days after the recall.**

Q I see.

So if the recall happens on settlement date trade date plus 3, how long does the counterparty have to return the shares to you?

A They have three days.

Q The beginning of the day, end of the day?

A By the close of business of T3.

(Hearing- Day 1, 225:11-226:13, Oct. 27, 2014)

- Johnson Testimony

Q And what do you believe you discussed with Mr. Delaney on that point?

A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and **they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.**

Q And you said, "by us not doing it the old way." What is that reference, sir?

A It's what you just said in this box that's sticking out. That's the way the industry has done it for years.

Q So by you not buying in the afternoon of T6; is that what you mean, sir?

A By buying in, we would always buy-in when -- when -- when -- when -- when -- when it was at the end of market.

(Hearing- Day 2, 518:24-519:15, Oct. 28, 2014)

83. Johnson was a vocal and direct personality; he was not afraid to raise issues and was direct if he needed something.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **McCain testified that, in his opinion**, Johnson was not quiet or meek; Johnson was not afraid to share his opinions; and Johnson was vocal and direct.
- c. Support:
  - McCain Testimony

Q You also discussed with Ms. Addleman Mike Johnson, right?  
 A Yes.  
 Q I want to talk for a minute about Mr. Johnson. You mentioned -- I think the terms you used, and if I'm putting words in your mouth, please correct me, but he was crass and crude; is that fair?  
 A Yes.  
 Q Was he quiet or meek?  
 A No.  
 Q Did he seem afraid to share his opinion if he had one?  
 A Never.  
 Q Did he often have opinions?  
 A Always.  
 Q Did he seem afraid to raise issues?  
 A Not that I know of.  
 Q He was vocal and direct; is that fair?  
 A Yes.  
 Q If fair to say if he wanted something, he would let you know?  
 A He would.

(Hearing- Day 9, 2226:11-2227:7, Nov. 6, 2014)

84. During his conversations with Delaney, Johnson made it clear to Delaney the problem Stock Loan was having.

- a. Response: **Dispute** – accuracy of statement; unclear as stated; contrary evidence in record.
- b. Counterstatement: Delaney consistently testified that he was not aware that Stock Loan had been intentionally violating Rule 204(a) prior to seeing the FINRA exam response in March 2011.
- c. Support:

Q: Prior to you seeing that FINRA exam response that we showed in Exhibit 89 a moment ago, had you ever had a conversation with anyone at Penson that left you with the understanding that Stock Loan wasn't closing out long sales of securities they had out on loan?

A No.

(Delaney, 1307:9-14, Oct. 31, 2014)

Q And let me ask you generally, and then we'll talk specifically. Was Mr. Delaney aware that those practices we just saw in Exhibit 89 were how Stock Loan was operated?

A I don't know

(Johnson, 517:19-23, Oct. 28, 2014)

- Exhibit 224 (Delaney Investigative Testimony) at pp. 90, 139

Q Were you aware of any systemic or policy level decisions from the stock loan group that were contrary to the requirement to close out fails to deliver on long sales by the open market T plus 6?

A Not systemic, no, sir.

(Delaney, Tom- INV vol I, 90:12-90:16, Apr. 4, 2012)

Q My question is for the stock loan department. During the time that you were the CCO of Pension Worldwide or PFSI, were you aware that the stock loan department had a policy of closing out Rule 204 close-outs after market?

A I was not aware of that.

(Delaney, Tom- INV vol I, 139:23-140:2, Apr. 4, 2012)

- Exhibit 224 (Delaney Investigative Testimony) at pp. 489 – 490

Okay. So was it in the course of drafting this March 2011 letter to FINRA that you first learned that as a matter of practice Stock Loan group was not closing out fails-to-deliver of long sales in accordance with Rule 204A?

A It was in the process of making that response. Drafting the letter may have taken a couple of days. There would have been stuff in front of that. It could have been a couple of days but it was around -- generally around that time that I -- that I recall learning of this.

(Delaney, Tom- INV vol III, 489:22-490:5, July 31, 2013)

85. During those conversations, Johnson informed Delaney that there was a conflict between the Rule and the historic practice of buying in borrowing counterparties on the afternoon of T+6, three days after a recall was issued on T+3, based on the terms of the MSLA. Johnson further informed Delaney that PFSI's counterparties were not accepting buy-ins at market-open T+6.

- a. Response: **Dispute** – unclear as stated; not supported by evidence cited by the Division.
- b. Counterstatement: At the time of the conversations **referenced in Division's Finding of Fact 80, DeLaSierra testified that Counterparties believed** they could not be closed out on long sales of loaned securities **until the close of T+6** under the terms of the MSLA because the MSLA did not allow PFSI to buy-in the borrowing counterparty until the afternoon of the third day after the recall was issued.

c. Support: See response to Division's FOF 82.

86. In his conversations with Delaney, Johnson sought guidance from Delaney on how to comply with Rule 204.

a. Response: **Dispute** – accuracy of statement; contrary evidence in record.

b. Counterstatement: Delaney testified that Johnson did not ask for guidance on how to comply with Rule 204, but rather complained about counter-party pushback. Johnson expressed concern and frustration about the Rule changes as compares to what had been industry practice.

c. Support:

- Delaney Testimony

Q Okay. We'll talk about some of those conversations in detail. But for present purposes, did you ever have a conversation with Mike Johnson?

A I did.

Q What do you recall about that conversation, including the time, if you can give us your best estimate?

A It was around the time when we were communicating out the 204T requirements. Mike Johnson had expressed some concern that he was getting counter-party pushback, and -- **and -- and he was just voicing his -- his concern and frustration with me about that.**

Q Did you understand what he meant by "counter-party pushback"?

A I believe I understood it at the time, yes.

Q Okay. Did you give any response?

A I did.

Q What -- what was your response?

A If -- if you know Mike Johnson personally, he's -- he's a pretty interesting character; and I think I recollect my response being something like, Mike, if you don't like the rule, you need to go to Congress and/or write your congressman.

Q Why did you say that?

A **His complaint about the rule, to me** -- I had no ability to change the rule from a compliance standpoint. And so, at that point, I -- I -- he was expressing some frustration, and that really -- the rule is the rule, and this is really what he -- his avenue would be to go through whatever legislative process he could in order to affect a rule change.

Q **Did he, at that point, ask you for any guidance?**

A **He did not.**

(Hearing- Day 5, 1192:12-1193:20, Oct. 31, 2014)

87. Stock Loan sought guidance from Delaney because he was the Chief Compliance Officer and they wanted to make him aware that there was a conflict between the Rule's requirements and counterparties stating that Stock Loan could not execute close-outs at market-open based on the terms of PFSI's recall letters.

- a. Response: *Dispute* – unclear as stated; contradictory evidence in the record.
- b. Counterstatement: De La Sierra testified that Stock Loan did not consult with anyone from Compliance about Rule 204. De la Sierra also testified that he never told Compliance that he understood Rule 204T required buying in sometime other than market open T+6.
- c. Support:
  - De La Sierra Testimony

Q And the first one was in 2012, the spring or fall. For some reason I'm remembering fall and probably wrong, but we can resolve that pretty quickly. I am, in fact, wrong. So in the spring of 2012, you testified. And do you recall if you were asked whether Compliance knew about this practice?

A Yes.

Q Okay. You recall that you were asked that?

A I recall that I was asked that, yes.

**Q And the first thing that you were asked was: At the time that Rule 204T came out, did the Stock Loan department consult with anyone from Compliance? And then I think the question -- maybe the question was going to go on. I think Mr. Warner was the one asking it, and it got cut off. And what did you answer?**

**A I said we did not consult with them.**

Q Okay. So that was back in 2012. And as we covered earlier, you remembered events a little bit more clearly then?

A Yes.

**Q And you testified that when 204T came out, you didn't consult with anyone from Compliance?**

**A Consult, yes. We did not consult.**

(Hearing-Day 1, 265:21-266:10, Oct. 27, 2014)

Q You -- you testified that you understood from the very beginning of 204T, that it required you to buy in at market open on T+6; is that right?

A Correct.

Q I mean, and you -- you read the rule and -- and came to that conclusion?

A Correct.

**Q Did you ever tell anybody in compliance that you had an understanding that the rule required something else?**

**A No.**

(Hearing-Day 1, 264:9-19, Oct. 27, 2014)

88. Part of the role of a compliance officer is to give guidance on rules.

- a. Response: *No dispute*.

89. Poppalardo would have expected a CCO asked for guidance to provide assistance.

- a. Response: **Dispute** – accuracy of statement and unclear as stated.
- b. Counterstatement: Poppalardo would have expected, **to the extent a CCO became aware of an issue, that he would work with the business line to address the problem.**
- c. Support:
  - Poppalardo Testimony

Q Okay. If a -- if a business line person were to come to a CCO and say, We can't figure out how to comply with this new rule, **what would you expect the CCO to do?**

A Pull together a working group, figure out, you know, what needed to be done, whether it was revising an automated -- reprogramming an automated system or, you know, working within the firm to make sure that you were able to comply.

Q Would you expect the CCO to take steps to understand what the problem was?

A I think that if the problem is clear on its face and it was something that was programmed into an automated system, you don't need to know all of the details; you just need to know that you have an IT problem and you need to get that fixed. But, you know, it really -- it depends on the situation.

Q Okay. But it sounds like you would expect the CCO to take some steps; is that right?

A **I would expect the CCO, to the extent that it came to his attention, he became aware of it, once you become aware of something, you've got to do something. So to work with the business line and to figure out how to fix -- address the problem.**

(Hearing- Day 8, 2029:9-2030:7, Nov. 5, 2014)

90. Stock Loan took guidance from compliance seriously, and followed that guidance when it was given.

- a. Response: **Dispute** – accuracy of statement; incomplete.
- b. Counterstatement: Stock Loan took guidance from compliance seriously, and followed that guidance when it was given. **Stock loan did not seek guidance from Compliance when Rule 204 was adopted in September 2008.**
- c. Support:
  - De La Sierra Testimony

Q Mr. De La Sierra, did you take compliance seriously at Penson?

A Yes, we did.

Q Were there ever instances where the Compliance department gave you guidance and you complied?

A Yes.

(Hearing- Day 1, 240:9-240:14, Oct. 27, 2014)

Q And the first one was in 2012, the spring or fall. For some reason I'm remembering fall and probably wrong, but we can resolve that pretty quickly. I am, in fact, wrong. So in the spring of 2012, you testified. And do you recall if you were asked whether Compliance knew about this practice?

A Yes.

Q Okay. You recall that you were asked that?

A I recall that I was asked that, yes.

Q And the first thing that you were asked was: At the time that Rule 204T came out, did the Stock Loan department consult with anyone from Compliance? And then I think the question -- maybe the question was going to go on. I think Mr. Warner was the one asking it, and it got cut off. And what did you answer?

A **I said we did not consult with them.**

Q Okay. So that was back in 2012. And as we covered earlier, you remembered events a little bit more clearly then?

A Yes.

Q And you testified that when 204T came out, you didn't consult with anyone from Compliance?

A **Consult, yes. We did not consult.**

(Hearing-Day 1, 265:21-266:10, Oct. 27, 2014)

91. Rather than provide guidance to Stock Loan on how it could comply with Rule 204, Delaney told Johnson to "call your Congressman" if he had problems with the rule.

- a. Response: **Dispute**. The Divisions statement is unsupported by the record and constitutes impermissible argument. *See* Post-Hearing Order.
- b. Counterstatement: Delaney testified he told Johnson that "the rule is the rule" and if he didn't like it "you need to go to Congress."
- c. Support:
  - Delaney Testimony

Q Okay. We'll talk about some of those conversations in detail. But for present purposes, did you ever have a conversation with Mike Johnson?

A I did.

Q What do you recall about that conversation, including the time, if you can give us your best estimate?

A It was around the time when we were communicating out the 204T requirements. Mike Johnson had expressed some concern that he was getting counter-party pushback, and -- and --



and he was just voicing his -- his concern and frustration with me about that.

Q Did you understand what he meant by "counter-party pushback"?

A I believe I understood it at the time, yes.

Q Okay. Did you give any response?

A I did.

Q What -- what was your response?

A If -- if you know Mike Johnson personally, he's -- he's a pretty interesting character; and I think I recollect my response being something like, **Mike, if you don't like the rule, you need to go to Congress and/or write your congressman.**

Q Why did you say that?

A His complaint about the rule, to me -- I had no ability to change the rule from a compliance standpoint. And so, at that point, I -- I -- he was expressing some frustration, and that really -- the **rule is the rule**, and this is really what he -- **his avenue would be to go through whatever legislative process he could in order to affect a rule change.**

(Hearing- Day 5, 1192:12-1193:18, Oct. 31, 2014)

92. At approximately the same time that Johnson and Delaney were discussing Stock Loan's compliance issues, Delaney and Rudy De La Sierra had a conversation in which Delaney asked whether Stock Loan was still having issues with market-open buy-ins, and De La Sierra confirmed that Stock Loan had not resolved the issues.

- a. Response: **Dispute** – accuracy of statement; contrary evidence in the record.
- b. Counterstatement: Delaney was not aware of Stock Loan's Rule 204 violations until March 2011.
- c. Support: See response to Division's FOF 63a; see also Delaney's response to Division's FOF 92.

93. In response to De La Sierra confirming that Stock Loan was still not able to buy-in at the market open on T+6, Delaney simply said "okay." Delaney did not instruct De La Sierra that Stock Loan had to comply with the market-open requirement of Rule 204 regardless of any counterparty resistance.

- a. Response: **Dispute** – accuracy of statement; contrary evidence in the record.
- b. Counterstatement: Delaney was not aware of Stock Loan's Rule 204 violations until March 2011.
- c. Support: See response to Division's FOF 63a; see also Delaney's response to Division's FOF 93.

94. Stock Loan did not hide from Delaney the fact that it was not closing out fails to deliver at market-open T+6.

- a. Response: **Dispute** – accuracy of statement; contrary evidence in the record.
- b. Counterstatement: Delaney was not aware of Stock Loan’s Rule 204 violations until March 2011.
- c. Support: See response to Division’s FOF 63a; see also Delaney’s response to Division’s FOF 94.

95. Stock Loan told Tom Delaney that Stock Loan’s practice was to close-out fails to deliver on long sales on the afternoon of T+6.

- a. Response: **Dispute** – accuracy of statement; ambiguous as to timing; contrary evidence in the record.
- b. Counterstatement: Delaney was not aware of Stock Loan’s practice regarding Rule 204 until March 2011.
- c. Support: See response to Division’s FOF 63a; see also Delaney’s response to Division’s FOF 94.

96. On September 21, 2008, Delaney received and read guidance that the Commission had issued an emergency order requiring close-out at market open T+6 of all fails to deliver due to long sales.

- a. Response: **No dispute**. Clarification needed - the Division cites to Stip. FOF 84 for support and the correction stipulation is **Stip. FOF 85**.

97. In October 2008 Morgan Lewis issued additional guidance about Rule 204T. It was Delaney’s practice to review Morgan Lewis’s guidance carefully. This guidance specifically discussed the impact of Rule 204T on securities lending. The guidance also linked to the Rule 204T adopting release.

- a. Response: **No dispute**.

98. Delaney also read the adopting release for Rule 204T.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Delaney **saw** the adopting release for Rule 204T.
- c. Support:
  - Delaney Testimony

Q So you've seen Exhibit 67. You've seen the adopting release for Rule 204T; is that correct?  
 A I said that here, but I stand my by answer that I think my intention was that **I don't know if I specifically saw it off the Federal Register. But I certainly would have seen it** in some other

context of the rules being released.

(Hearing- Day 2, 576:12-576:18, Oct. 28, 2014)

99. Delaney was aware of the tension between the close-out requirements of Rule 204T and securities lending practices.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Delaney was **generally** aware of **the opinion that there was** tension between the close-out requirements of Rule 204T and general securities lending **industry** practices, **but not Penson-specific practices**.
- c. Support:
  - Exhibit 224 (Delaney Investigative Testimony) at p. 404

Q Were you aware of any tension between Rule 204T's closeout requirements and securities lending practices?

A I was **generally aware** that there was discussions out there of **potential for that but not specific to Penson**. It was more of an **industry discussion**.

(Delaney, Tom- INV vol III, 404:1-404:5, July 31, 2013)

100. On December 13, 2008, Delaney received comments about Rule 204T. The e-mail noted that “Rule 204T applies to long sales, not just short sales. Unfortunately, the timelines set by the rule do not match the timelines in the securities lending markets” and asked PFSI to write a comment letter to the Commission concerning adoption of the rule.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: On December 13, 2008, Delaney was **forwarded an email from Phil Pendergraft** about Rule 204T. The e-mail, **drafted by individuals not employed by Penson**, noted that “Rule 204T applies to long sales, not just short sales. Unfortunately, the timelines set by the rule do not match the timelines in the securities lending markets” and asked PFSI to write a comment letter to the Commission concerning adoption of the rule.
- c. Support:
  - Exhibit 160, at pp. PFSI2325526 – 27

----- Original Message -----

From: Phil Pendergraft

To: Andy Koslow; Mike Johnson; Tom Delaney; Bill Yancey

Sent: Sat Dec 13 16:32:51 2008

Subject: Fw: SEC Rule 204T – Comments needed

Mike & I are writing you regarding the SEC's interim final temporary Rule 204T (the "hard close-out rule"). While the rule has had some positive effects in reducing fails to deliver, it also has had significant negative unintended consequences on broker-dealer financing and stock market volatility. We think that these negative effects can be largely mitigated by a few simple clarifications to the rule, as detailed below and in the attached letter. In furtherance of these clarifications, which we believe are critical to the efficient functioning of the securities lending market, we have spoken to the SEC about our concerns and written a comment letter on the Rule as well (attached). We urge you to do the same before the expiration of the comment period next Tuesday, December 16.

Rule 204T applies to long sales, not just short sales. Unfortunately, the timelines set by the rule do not match the timelines in the securities lending markets, and this contradiction leaves brokers with an unattractive choice: either risk violating the rule or curtail securities lending. Since the Rule became effective in late September, the broad securities lending market has shrunk by 50%, reducing cash liquidity to the finance industry when the industry needs it most – broker-dealers with excess cash balances hoard their cash and refuse to lend, while broker-dealers who have cash needs draw on bank lines (concentrating counterparty risk and reducing credit availability to other bank customers).

101. On December 15, 2008, Delaney received a comment letter concerning Rule 204T written by the Securities Industry and Financial Markets Association ("SIFMA"). This letter contained a whole section on the impact of Rule 204T on stock lending. Among other things, the letter discussed the conflict between stock lending practices and Rule 204T.

a. Response: *No dispute*.

102. In July and August, 2009, Delaney reviewed additional guidance from PFSI's legal advisors. This guidance provided a link to the adopting release for Rule 204. Delaney testified that it was his practice to review the links in such guidance.

a. Response: *No dispute*.

103. The adopting release for Rule 204 specifically discussed the "effect of the requirements of temporary Rule 204T on securities lending" and noted the conflict between the "completion of the securities lending cycle" and the requirements of the rule. Nonetheless, in the next paragraph the Commission reiterated that despite the impact on securities lending, the Commission would keep the closeout requirements.

a. Response: *No dispute*.

104. In August 2010, Compliance Officer Eric Alaniz sent Delaney an e-mail attaching guidance concerning Rule 204. The guidance repeated a portion of the August 2009 adopting release, and two of the nine paragraphs in the guidance discussed the conflict between the securities lending practices and Rule 204's requirements.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: In August 2010, Compliance Officer Eric Alaniz **sent Alan Zabloudil, and copied Delaney and others**, an email discussing buying pressure at the market open that may temporarily distort the price of the security and

explain that the trading desk adheres to the per-market or market open “close-out” requirement of Rule 204.

c. Support:

- Exhibit 328

**From:** Eric Alaniz  
**Sent:** Friday, August 20, 2010 11:27 AM  
**To:** Alan Zabloudil  
**Cc:** Jimmy Glasgow; Thomas Textor; Tom Delaney  
**Subject:** Buy-Ins Per Rule 204  
**Importance:** High

Alan,

The below discussion addresses the same concern(s), buying pressure at the open that may temporarily distort the price of the security, PFSI had today on a buy-in order. As an FYI, Cobra is notified the day before of this buy-in, prior to PFSI taking action, to deliver this position or buy-in their client. Inaction on the part of Cobra requires the Clearing agent, in this case PFSI, to take action as prescribed in the Rule below.

Unfortunately per Rule 204 (see below) the trading desk must adhere to the guidance below. Buy-Ins for “fail to deliver” (FTDs) securities must be placed at pre-market or at market open (9:30 EST) either as a market or “VWAP (order type that more effectively manages the buy-in risk)” order to meet the Rule 204 “Close Out” requirements. These two options should be adequate to minimize price volatility (see VWAP). If the “close-out” requirement is not met it becomes a violation of Rule 204.

Please review the following discussion below. If after reviewing you still have any questions please feel free to contact me at x3446.

105. In December 2009, PFSI’s Compliance department did testing pursuant to FINRA Rule 3012 of PFSI’s compliance with Rule 204 (the “Rule 204 Test”).

a. Response: *No dispute.*

106. Alaniz discussed the December 2009 testing with Delaney before doing the testing.

a. Response: *Dispute* – accuracy of statement. The statement is unsupported by the cited testimony.

- b. Counterstatement: Alaniz's general process for conducting 3012 audits included discussing the proposed list of topics with Delaney.
- c. Support:
  - Alaniz Testimony

Q Okay. How did this audit come about? What caused this audit to occur?

A My basic -- **basic way I come up with any audit is that I had a process.** I reviewed FINRA sites, SEC sites. I would check in to our regulatory compliance area. I would ask to see what the regulators were asking about. **And then from there, I would gather a list of topics. From that point, I would take it to Tom Delaney. We'd create a list.** And then from there, we'd go have that list augmented or add to it if there were anything that needed to be added to it from Bill Yancey. And then from there, we'd develop what we would test throughout the year.

(Hearing- Day 3, 705:6-705:19, Oct. 29, 2014)

107. The December 2009 audit results related only to the Buy-Ins department.

- a. Response: *No dispute.*

108. Delaney claimed that his "procedures formed the basis of compliance testing at PFSI that reliably determined whether, and to what extent, PFSI was in compliance with Rule 204T, 203, and 204."

- a. Response: **Dispute.** The cited support is unreliable and reflects statements made in Delaney's Wells Submission, not Delaney's personal admissions. *See* Jan. 15, 2015 Order (noting that the Court is disinclined to rely upon the Wells submission of Thomas R. Delaney II because the Court has determined that the representations made therein are insufficiently reliable). Based on the Court's Jan. 15, 2015 Order, the Proposed FOF should be stricken.
- b. Support:
  - Exhibit 157 (Delaney Wells Submission) at p. 4

**The procedures Mr. Delaney implemented cannot be questioned. Indeed, Delaney's procedures formed the basis of compliance testing at PFSI that reliably determined whether and to what extent PFSI was in compliance with Rules 204T, 203 and 204. The procedures, then,**

109. Delaney **admits, however**, that the December 2009 compliance testing did not test whether Stock Loan was closing out long sales of loaned securities in compliance with Rule 204.

- a. Response: **Dispute** – accuracy of statement; contains impermissible argument.
- b. Counterstatement: Delaney testified that, **although the audit was intended to test long sales of loaned securities**, the December 2009 compliance testing **did not test** close-outs of long sales of loaned securities.

c. Support:

- Delaney Testimony

Q Okay. Did this 3012 testing, did it test the **close-outs of long sales when a stock loan was out?**

A I don't believe -- I don't believe that the testing ends -- ends up doing that.

Q Okay. So it did not test whether Stock Loan was closing out in compliance with Rule 204?

A **It was intended to test that, but I think at the end, and as we look through it now, it does not appear that it did.**

(Hearing- Day 2, 608:6-608:14, Oct. 28, 2014)

- Ex. 70 (Subject: SEC Rule 204)

#### **3012 Test Results**

**To:** Brian Hall & Rudy De La Sierra  
**From:** Eric Alaniz  
**Date:** December 21, 2009  
**Audit:** Securities Lending Department  
**Subject:** SEC Rule 204

110. Alaniz wrote a report summarizing the results of the December 2009 testing of Rule 204.

a. Response: *No dispute*.

111. The Rule 204 Test results showed that close-outs of short sales occurred between 30 minutes and 1 hour and 15 minutes after market open, close-outs of long sales occurred between 4 hours from market open to up until 11 minutes of the market close, and, of the 113 securities transactions tested, 112 failed to comply with Rule 204.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: The Rule 204 test results, **which tested short sale and long sale failure to deliver positions caused by customers over the course of a two week period**, showed that close-outs of **47** short sale **positions** occurred between 30 minutes and 1 hour and 15 minutes after market open, close-outs of **51** long sale **positions** occurred between 4 hours from market open to up until 11 minutes of the market close, and, of the 113 securities transactions tested, 112 failed to comply **with the close-out requirement of Rule 204**.

c. Support:

- Exhibit 70 at 2

*Review of the T+4 query/reports*

During the weeks of November 16<sup>th</sup> through the 20<sup>th</sup> and December 7<sup>th</sup> through the 11<sup>th</sup> there were a total of 62 required buy-ins as a result of "fail to deliver" positions ("FTDs") on the T+4 query/report. The Buy-In Department bought in 47 of the "FTD" positions while the other 15 were given to the correspondent to close out.

The 47 buy-ins placed by the Buy-In Department resulted in orders placed anywhere from 30 minutes to a 1 hour and 15 minutes after the market open.

*Review of the T+6 reports (EXT816)*

In the case of the T+6 (long sales) reports the Buy-In Department was required to close-out 51 "FTD" positions in the same time frame.

The 51 buy-ins placed by the Buy-In Department resulted in orders placed anywhere from 4 hours from the market open to up until 11 minutes of the market close.

***Final Result - The failure to comply with the close-out requirement placed 112 out of 113 securities in the "Penalty Box".***

112. This was one of the most significant occurrence of failures PFSI's compliance department had ever seen in its Rule 204 testing.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: **Alaniz testified that** the Rule 204 testing results were **"probably one of the more significant"** failures for the items that he tested.
- c. Support:
- Alaniz Testimony

Q Do you recall what the results of your testing were?

A Yes. I believe out of 113, 112 of those items that I reviewed had failed. They had not met the requirement of the rule.

Q Do you think that was a significant failure?

A For that time frame that I had tested, in that window, compared to my other audits, I would say it was **probably one of the more significant ones** out of my whole testing procedures, for items that I tested.

(Hearing- Day 3, 708:7-708:16, Oct. 29, 2014)

113. Delaney characterized these failures as "massive," "profound," and "anomalous."



- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 21 previously stipulated to by all parties, and there is no basis for a separate or additional finding of fact.
- b. Support:

FOF 21. On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Penson's compliance testing procedures. As part of that certification, Penson's Compliance Department prepared and presented an Annual Report that, per Penson's WSPs, was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violations resulting from Buy-Ins' procedures -- a compliance failure that Delaney later characterized as "massive," "profound," and "anomalous."

*See Order on Stipulations*

114. No other testing show similar failures.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Delaney could not recall** any other testing that showed a similar testing result.
- c. Support:
  - Delaney Testimony

A Other than -- other than -- other than Eric's testing with respect to those 113 items, I don't -- **I don't recall there being anything else that had a testing result that came out like that.**

(Hearing- Day 5, 1383:20-1383:23, Oct. 31, 2014)

115. Gover came to believe that some of the failures were attributable to PFSI's Stock Loan department.

- a. Response: **Dispute** – accuracy of statement. Contrary testimony in the record. The Division's statement is also contradicted by Stip. FOF 78, to which all parties have stipulated.
- b. Counterstatement: The Rule 204 test revealed issues related only to the Buy-Ins department. Gover testified that "[j]ust because there were issues in the buy-ins group of getting the executions done on time does not mean that there were issues in Stock Loan or were not issues in Stock Loan. They're separate."
- c. Support:

- Gover Testimony

A . . . **Just because there were issues in the buy-ins group of getting the executions done on time does not mean that there were issues in Stock Loan or were not issues in Stock Loan. They're separate.**

(Hearing-Day 1, 173:17-21, Oct. 27, 2014)

A . . . If you're saying given the audit around the buy-in's piece, no, I don't think that that would have given rise to a reasonable inquiry of the Stock Loan.

(Hearing-Day 1, 175:19-21, Oct. 27, 2014)

- Stip. FOF 78

FOF 78. The December 2009 audit and June 2010 follow-up 204(a) audit **results related only to the Buy-Ins Department.**

(See Order on Stipulations)

- Delaney Testimony

Q: . . . Mr. Alaniz's audit tested the buy-ins department. . . do you believe that an audit of a department that did not test whether there were failures to close out on long sales of loaned securities could ever be a red flag about failures to close out long sales of loaned securities in the Stock Loan Department?

A: No.

**Q: . . . you did not see a nexus - -**

**A: No**

(Hearing-Day 5, 1351:6-17, Oct. 31, 2014)

- *See also* Alaniz Test. at 855:11 – 856:12 (agreeing that based on his test results, it was not necessary to go to the Stock Loan Department); Gover Test. at 168:13-22 (“the December audit was focused only to . . . **It was focused on the processes within my group and where we were failing.**”), 170:5-13 (“Q: I guess the point I want to establish is that your group made an incredible effort, incredible effort at all times to comply with Rule 204(a); do you agree? A: We made -- we made an effort to comply with 204. **The results of the audit showed we weren't making buy-ins, my group.** The efforts weren't sufficient. But yes, the people in the group, they cared, they wanted to do the right thing, they wanted to comply with the regulations.”)

116. Between March 2010 and June 2010, Gover had a conversation with Delaney and Johnson. In that meeting, they discussed that CNS fails attributable to PFSI's Stock Loan department were not to be closed out. They also discussed the conflict between the buy-ins contemplated by the MSLA and required by Rule 204.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: Gover testified he had a recollection of a meeting with Delaney and others where Stock Loan expressed its views on Rule 204 and that Stock Loan was not to be “bought in,” but his testimony was contradicted by all of the alleged attendees of the meeting.
- c. Support:
  - Gover Testimony

Q Well, tell us -- why don't you tell us about those conversations, the conversations between you and --

A Sure.

Q -- Mr. Delaney --

A Yeah.

Q -- about Rule 20- -- 204 and Stock Loan.

A Well, I think the one that is probably germane to this conversation, or one of them anyways, we encountered an issue where we had a CNS obligation. We -- we -- we were short to CNS. And when we looked at our stock record, there were no -- there were no customers that were selling short that we could buy-in, and all of the excess stock was on loan. So it showed in a location of being stock on loan on the Stock Loan box. So we were presented with a situation where we had an obligation to buy-in, but the only party that we could buy-in would have been the Stock Loan department.

Q And so what happened?

A **It was escalated to me by the buy-ins group, and we had a conversation -- had requested a conversation with compliance and Stock Loan. And it was basically -- the -- the message we were getting from Stock Loan is that you don't buy-in Stock Loan.** And I'm looking at what I thought were our obligations under Reg SHO from my buy-ins group and saying, well, that kind of puts us in a bad position because I have an obligation to buy-in, but I've also got Stock Loan saying, you can't buy us in and there's nobody else that could buy-in. So that precipitated a discussion around the rule.

(Hearing- Day 1, 102:25-104:3, Oct. 27, 2014)

Q Okay. And how was the problem presented in that conversation?

A I am paraphrasing. But it was, okay, **Stock Loan is saying they don't get bought in**, and then here's me holding 204 and saying I've read the reg, and I don't see anywhere it gives -- where it gives me an out for that. So there were some discussions about, well, in order to have the shares for a loan sale, they should -- they would have to be recalled to -- they have to be recalled earlier. They have to have -- we have to have the shares -- if we've got shares, this is really -- this is -- gets really complicated. So if I need to clarify, please stop me.

Q Okay.

A . . . Where the -- where the point of discussion was, the Stock Loan compliance and buy-ins was -- I think **Stock Loan maintained that that wasn't industry practice and that the Stock Loan agreements, the MSLAs, weren't -- didn't support that. And so that's where we had a conflict.**

(Hearing- Day 1, 104:15-106:1, Oct. 27, 2014)

Q And you spoke earlier about a conversation that you had with Tom Delaney and Mike Johnson. **Can you put that into a time frame for us?** You took over buy-ins in August or September and --

A I will attempt.

Q Okay.

A And I do it -- you know, there's kind of like there -- I can put time frames around issues around when I think that happened. I believe that we -- that we had a couple of conversations, one when I first took over buy-ins, which would have been, to my recollection, third quarter of 2009. **I also believe that there was another conversation that occurred in -- sometime in the spring of 2010.** And, you know, it's kind of like, well, okay, I know I took buy-ins about when I -- you know, about a couple of months after I took Stock Loan. I know I hired a VP at Stock Loan in August. So, you know, it's within that range.

And I can also -- you know, as I move through the continuum of my career progression at -- at Penson, I can say, okay, I know that I wasn't -- well, you know, I wasn't -- I wasn't focused on buy-ins during, you know, the latter half of 2010 because I was focused more on margins because we were -- so is that helpful? I mean, I -- I can't say on, you know, July 29th we had this meeting.

Q Sure.

A **But to my recollection, that it was within the first six to nine months after my taking buy-ins that we had the conversations and the conflict on the Stock Loan over when the shares were recalled.**

(Hearing- Day 1, 117:16-118:21, Oct. 27, 2014)

Q Okay. And the last thing I want to ask you about is the meeting that you had with Mr. Delaney and Mr. Johnson, and I just wanted to kind of circle back around and say, is there anything that you heard on cross-examination that has changed your mind about when you think that meeting occurred?

A Not substantially, no. I mean, it was -- it felt chronologically like it was pretty close to when I had took over the team. I know that I had a lot of other things that started to get -- you know, grabbing my attention beginning late summer of 2010. And, you know, based on the exhibits that I had seen that accompanied my -- my declaration and then some of the other e-mails that I had seen, it seems pretty consistent with my recollection that it was, you know, **somewhere between March and June of 2010.**

(Hearing- Day 1, 197:4-197:19, Oct. 27, 2014)

- **But see**

- Hasty Testimony

**Q Do you recall ever having a meeting with [Gover] where it was discussed that Stock Loan was choosing not to close out in accordance with Rule 204?**

A No.

Q So you don't recall that meeting ever happening?

A No.

Q Do you recall ever being in -- in a meeting with him and Summer Poldrack related to Rule 204 at all?

A No.

(Hearing-Day 7, 1756:10-20, Nov. 3, 2014)

○ Johnson Testimony

Q Mr. Johnson, did you ever have a meeting with Brian Gover where you discussed the possibility of recalling loans on T+2 to close out to 204 fails?

A Never.

(Hearing-Day 2, 568:14-17, Oct. 28, 2014)

○ Delaney Testimony

Q Do you recall Mr. Gover's testimony that he met with you?

A I do.

Q Do you remember ever having a meeting with Mr. Gover where he discussed compliance with Rule 204? Probably I asked that too broadly. **Discussed a practice by Stock Loan of not -- of deliberately not closing out long sales of securities they had out on loan?**

A No.

(Hearing-Day 5, 1308:3-11, Oct. 31, 2014)

117. Delaney was responsible for ensuring that PFSI's WSPs reflected relevant regulatory guidance in Stock Loan's close-out practices.

- a. Response: **Dispute** – accuracy of statement; incomplete recitation of the record.
- b. Counterstatement: The Compliance department and Business units worked collaboratively in many aspects of drafting and reviewing WSPs.
- c. Support:
  - Alaniz Testimony

Q: And do you do that kind of in isolation or is it a collaborative process with -- with the business units?

A: It's collaborative.

(Hearing-Day 3, 726:3-6, Oct. 29, 2014)

Q: And do you rely on those business units for information about what is going on at the firm?  
A: Yes.

(Hearing-Day 3, 726:15-17, Oct. 29, 2014)

**Q: Was it typical of your experience in -- as a Compliance Officer that you would identify problems and the business units would come up with the most efficient solutions to -- to solve those problems?**

**A: It was typical, yes.**

(Hearing-Day 3, 784:25-785:4, Oct. 29, 2014)

- Hasty Testimony

Q Who was it who was responsible for generating the **WSPs** related to a business unit?

A So it was a **responsibility of the business unit to convey to compliance** what they were doing, how they were supervising their business, what documents they were using to evidence supervision of their business.

(Hearing-Day 7, 1758:3-10, Nov. 4, 2014)

Q Why is it that the business unit originated that?

A Well, they're the experts. They are the people who are doing this day to day. As Compliance Officers, we're not experts in every area of the business. We don't sit at someone's desk and process buy-ins or use the reports or, you know, escalate certain items to our supervisors. We're unfamiliar with the process. We're unfamiliar in general with what they're doing on a day-to-day basis. **So it's absolutely is necessary to have the business owners be the original people who are drafting those WSPs and providing the information so that we can make sure it's accurate and that it includes what's really being done day to day.**

(Hearing-Day 7, 1758:13-1759:2, Nov. 4, 2014)

118. On January 25, 2010, Delaney asked Compliance Officer Eric Alaniz to review certain WSPs to see how they reconciled with his testing. Among other things, Alaniz recommended that “as much as they can, I'd recommend to consolidate them and include how Sendero will adjust for T +4's and T+6's close-out requirement “of Rule 204 and to “include close-out requirement procedures in the WSPs.”

- a. Response: ***No dispute.***

119. Although Delaney claimed that he was “working to close” “the gap” “between PFSI's WSPs and Stock Loan's practices concerning timely buy-ins,” Delaney admits that PFSI's March 31, 2010 WSPs, which Delaney specifically reviewed and approved, did not contain procedures for closing-out long sales.

- a. Response: *Dispute* – statement contains impermissible argument and mischaracterizes the cited support. Also, the cited support is unreliable and reflects statements made in Delaney’s Wells Submission, not Delaney’s personal admissions. *See* Jan. 15, 2015 Order (noting that the Court is disinclined to rely upon the Wells submission of Thomas R. Delaney II because the Court has determined that the representations made therein are insufficiently reliable).
- b. Counterstatement: Pensons’s WSPs were deemed “perfectly adequate” by expert witness Poppalardo and contained procedures for closing-out long sales, including long sales of loaned securities.
- c. Support:
  - Exhibit 188

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**Penson Financial Services**  
**BD Written Supervisory Policies and Procedures**  
*3/31/2010 to Current*

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- Exhibit 188 at 318

**House Buy-Ins**

Periodically based on Recalls and due dates.

- | Buy-Ins can be on the borrow or loan side.
- | If an item must proceed to a Buy-In then Stock Loan Operations Personnel inform the counterparty that a Buy-in will occur on that day.
- | Stock Loan writes a trade ticket and provide to the Agency Trading Desk for execution.
- | The counterparty is called back with an execution price.
- | The contacts are cleaned up into the Buy-In accounts waiting to pass final collections due on settlement date.
- | Buy-Ins on house borrows are relatively the same with the counterparty performing the buy-in completing most of the phone calls
- | If Stock Loan does not have a counterparty to pass the Buy-In to, then the Buy-In is forwarded to the customer Buy-In department.

**Documentation/Evidence**

- Exhibit 188 at 317

### **House Borrow and Loan Recalls**

#### **Daily.**

- | Sendero receives all house deficits and fall to delivers from Phase 3.
- | Equity and Finance Staff issue recall letters
- | Recalls are tracked and based on stock record they can be cancelled at any point, left open or bought in to clean up the purpose of the recall.

#### **Documentation/Evidence**

#### **Sendero and LOANET**

**Sendero and LOANET save all recall data records. All issued letters are saved in the daily work flow.**

317

- Poppalardo Testimony

A Okay. Yes, I did look at PFSI's policies and procedures. And I think what I would say is you start with, you know, as a general matter, you look at all of the key elements of the rule, and you make sure that those are reflected in the policies and procedures and to -- for the Reg SHO, certainly the important things are, you know, that the orders be marked correctly, locate and delivery requirements, close-out requirements and the penalty box restrictions. And I saw all of those elements in the PFSI policies, albeit in not necessarily a single policy because there are separate and distinct responsibilities within different groups in PFSI.

**Q How did they compare to what you've seen in the industry with respect to policies and procedures?**

**A Relating to Reg SHO, I think their policies and procedures overall were very comprehensive. And we've seen better, but, you know, they're -- they're perfectly adequate. In connection with Reg SHO, it's a really complicated area. I see a lot of policies and procedures and it took me a really long time to parse through them, but I do think that -- I think they were okay.**

(Hearing-Day 8, 1993:16-1994:13, Nov. 5, 2014)

Q Can you tell me, did anything in the cross-examination questions that Ms. Atkinson asked change your opinion that PFSI policies and procedures were consistent with what you saw in the industry?

MS. ATKINSON: I'm going to object to that as leading.

JUDGE PATIL: Overruled.

**A No, I -- I think they're consistent with -- with other policies and procedures that I've seen.**

(Hearing-Day 8, 2039:23-2040:6, Nov. 5, 2014)

120. Nor did PFSI's December 30, 2010 WSPs contain procedures for closing-out long sales.

- a. Response: *Dispute* – accuracy of statement.



- b. Counterstatement: PFSI's December 30, 2010 WSPs contained procedures for closing-out long sales.
- c. Support:
  - Exhibit 211 at pg. 11-12

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**Penson Financial Services**  
**BD Written Supervisory Policies and Procedures**  
12/30/2010 to Current

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**CLOSE-OUT REQUIREMENTS FOR FAIL TO DELIVER**  
 [SEC Rule 10b-21; Regulation SHO Rule 204]

"Naked Short Selling" is an abusive practice where the seller does not intend to deliver securities in time for settlement (including deceiving a broker-dealer about their locate source or ownership of shares). Close-out requirements apply to all equity securities. Obligations to close-out fails to deliver are the responsibility of the participant of a registered clearing agency, i.e., a broker-dealer that self-clears its own trades or the clearing firm on behalf of an introducing firm.

To prevent this abusive practice, the SEC has imposed requirements that securities must be delivered for Short Sales of all equity securities by settlement date (T+3). If securities are not delivered by settlement day, the Broker/Dealer is obligated to close out the position by borrowing or purchasing securities by the beginning of regular trading hours on the settlement day following the settlement date (T+4). For long sales, the BD must close out the position no later than the beginning of regular trading hours on the 3<sup>rd</sup> consecutive settlement day following the settlement date (T+6).

For sales of securities under Rule 144, the close-out requirement is triggered on the 35<sup>th</sup> consecutive settlement day after the settlement date for the sale in that security. Fails to deliver of Rule 144 securities must be closed out no later than the beginning of regular trading hours on the 36<sup>th</sup> consecutive settlement day following the settlement day for the transaction (T+3+36).

When a BD fails to close out a position as required under this rule, the BD may not accept a short sale order in that security from another person or effect an order in its own account until the fail to deliver is closed out.

- Ex. 746 at pg. 339

To prevent this abusive practice, the SEC has imposed requirements that securities must be delivered for Short Sales of all equity securities by settlement date (T+3). If securities are not delivered by settlement day, the Broker/Dealer is obligated to close out the position by borrowing or purchasing securities by the beginning of regular trading hours on the settlement day following the settlement date (T+4). For long sales, the BD must close out the position no later than the beginning of regular trading hours on the 3<sup>rd</sup> consecutive settlement day following the settlement date (T+6).

- Ex. 211 at pg. 4

### House Buy-Ins

Periodically based on Recalls and due dates.

- # Buy-Ins can be on the borrow or loan side.
- # If an item must proceed to a Buy-In then Stock Loan Operations Personnel inform the counterparty that a Buy-in will occur on that day.
- # Stock Loan writes a trade ticket and provide to the Agency Trading Desk for execution.
- # The counterparty is called back with an execution price.
- # The contacts are cleaned up into the Buy-In accounts waiting to pass final collections due on settlement date.
- # Buy-Ins on house borrows are relatively the same with the counterparty performing the buy-in completing most of the phone calls
- # If Stock Loan does not have a counterparty to pass the Buy-In to, then the Buy-In is forwarded to the customer Buy-In department.

121. In fact, the procedures identified as “PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204” in the WSPs primarily dealt with Rule 203, not Rule 204.

- a. Response: Dispute – accuracy of statement.
- b. Counterstatement: Penson’s Reg SHO and Rule 204 policies and procedures addressed (1) all elements of the rule, (2) set out specific procedures to follow, and (3) identified individuals and supervisors responsible for compliance.
- c. Support:
  - Ex. 828 at 10-12 (Poppalardo Report).

~~the policies that are unique to a firm’s business.~~

I have reviewed the relevant PFSI policies and procedures in place during the relevant period and conclude that they are reasonably designed. PFSI’s WSPs generally state rule requirements or prohibitions (citing to the relevant regulation in most cases), the designated principal(s) (by title) who is responsible for supervising the activity, and how the supervisor documents his or her review of the activity. The policies and procedures are sufficient to put registered personnel on notice of regulatory requirements and Firm practices, and they clearly vest supervisory responsibility in specific individuals as required by NASD Conduct Rule 3010.

PFSI WSPs address an array of subjects. The scope of the areas addressed in these documents is consistent with similar documents prepared by other broker-dealers and, in my opinion, also consistent with what the SEC and FINRA would reasonably expect the WSPs to contain. The policies and procedures address training requirements, *i.e.*, annual Compliance meeting and Firm Element training, hiring, on-boarding of correspondents, and other important elements of a supervisory system. Notably, PFSI had separate procedures that governed the activities and responsibilities of Compliance department personnel. This is not a regulatory requirement, but a *best practice* that Finseg typically recommends when assisting firms in developing policies and procedures.

- Ex. 211 at 3-14

**Penson Financial Services**  
**BD Written Supervisory Policies and Procedures**  
*12/30/2010 to Current*

**SECURITIES LENDING (STOCK LOAN) - DALLAS OFFICE II - RULE 204**

- Ex. 746 at 325-341

**CLOSE-OUT REQUIREMENTS FOR FAIL TO DELIVER**

[SEC Rule 10b-21; Regulation SHO Rule 204]

"Naked Short Selling" is an abusive practice where the seller does not intend to deliver securities in time for settlement (including deceiving a broker-dealer about their locate source or ownership of shares). Close-out requirements apply to all equity securities. Obligations to close-out fails to deliver are the responsibility of the participant of a registered clearing agency, *i.e.*, a broker-dealer that self-clears its own trades or the clearing firm on behalf of an introducing firm.

To prevent this abusive practice, the SEC has imposed requirements that securities must be delivered for Short Sales of all equity securities by settlement date (T+3). If securities are not delivered by settlement day, the Broker/Dealer is obligated to close out the position by borrowing or purchasing securities by the beginning of regular trading hours on the settlement day following the settlement date (T+4). For long sales, the BD must close out the position no later than the beginning of regular trading hours on the 3<sup>rd</sup> consecutive settlement day following the settlement date (T+6).

For sales of securities under Rule 144, the close-out requirement is triggered on the 35<sup>th</sup> consecutive settlement day after the settlement date for the sale in that security. Fails to deliver of Rule 144 securities must be closed out no later than the beginning of regular trading hours on the 36<sup>th</sup> consecutive settlement day following the settlement day for the transaction (T+3+36).

When a BD fails to close out a position as required under this rule, the BD may not accept a short sale order in that security from another person or effect an order in its own account until the fail to deliver is closed out.

- *see also* Ex. 540 at 383-399

122. On May 17, 2010, Delaney received notice that FINRA had detected that PFSI had not closed out long sales in compliance with Rule 204.

- a. Response: *No dispute*.

123. Delaney did nothing to follow-up on the notice in Exhibit 168 that FINRA had detected that PFSI had not closed out long sales in compliance with Rule 204.

- a. Response: *Dispute* – accuracy of statement; mischaracterization of testimony; overly broad.
- b. Counterstatement: Delaney testified that **he did not know whether** he did anything to follow-up on the notice in Exhibit 168.
- c. Support:

- Delaney Testimony

Q Okay. What did you do to follow up on what Ms. Miller told the FINRA person?  
A I may be missing, but I don't see where I'm being requested to follow up on anything.  
Q So do I take that to mean you did nothing to follow up on this; is that right?  
A **I don't know if I -- if I'd done anything.** I don't see anything here that says that I followed up on it.  
Q So you --  
A Whether I did or didn't, I don't know.  
Q You don't have any recollection of following up on this?  
A No.

(Hearing- Day 2, 597:23-598:11, Oct. 28, 2014)

124. On July 26, 2010, Delaney received an e-mail indicating that fails attributable to PFSI's Stock Loan department were not to be closed out.

a. Response: **Dispute** – accuracy of statement.

b. Counterstatement: On July 26, 2010, Delaney was copied on an e-mail in which Alaniz provided advice regarding fails attributable to PFSI's Stock Loan department.

c. Support:

- Exhibit 158 at p. 1, 3

**From:** Eric Alaniz  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=EALANIZ>  
**Sent:** Monday, July 26, 2010 7:40 AM  
**To:** Summer Poldrack <[REDACTED]@PENSON.COM>  
**Cc:** Tom Delaney <[REDACTED]@PENSON.COM>; Brian Gover  
<[REDACTED]@PENSON.COM>; Jerry Reilly <[REDACTED]@PENSON.COM>;  
Holly Hasty <[REDACTED]@PENSON.COM>  
**Subject:** RE: \*\*\*REG SHO\*\*\*-

Summer,

This is correct the Stock Loan account should be flat by the end of the day or have a surplus. Preferably this should be completed prior to or at market open. I will notify Rudy and Brian. Summer would you call me up when you have a second.

125. On October 13, 2010, Brian Gover **again** elevated the issue of **Stock Loan's closeouts of long sales**.

- a. Response: *Dispute*. The Division's statement is not supported by the cited evidence or the record. Exhibit 26 relates to Ridge customers, not PFSI Stock Loan shares on loan.
- b. Counterstatement: On October 13, 2010, Brian Gover elevated an issue related to Ridge and Rule 204.
- c. Support:
  - There is no evidence in the record that shows Brian Gover had previously escalated a similar issue.
  - Exhibit 26 at PENSON0009044-45

**From:** Brian Gover  
**Sent:** Wednesday, October 13, 2010 1:18 PM  
**To:** Mitch Mintz  
**Cc:** Conti, Anthony; Rudy De La Sierra; Mike Johnson; Brian Hall; Joe Gagliardi; Barillo, Joe; Tom Delaney; Thomas Textor; Jerry Reilly; Summer Poldrack; Tracie Pittman  
**Subject:** RE: REG SHO 204 Notification

Mitch- Bringing Compliance (Tom Delaney and Tom Textor) into the discussion. If I am getting this correct, we are essentially saying that for Ridge Customers although we can borrow to cover a failing long sale, we will not do so unless the correspondent contacts Stock Loan to arrange the borrow and agree the rate. Is that accurate?

Thanks

Brian

**From:** Mintz, Mitchell J [mailto:Mitchell.████████@ridgeclearing.com]



**From:** Rudy De La Sierra [mailto:████████@PENSON.COM]  
**Sent:** Wednesday, October 13, 2010  
**To:** Clearing, REG SHO 204  
**Cc:** Mike Johnson; Brian Hall  
**Subject:** RE: \*\*\*REG SHO\*\*\*-AUMN

The language I've highlighted needs to be reviewed. We do not borrow for long sales. If the short is due to a long sale then we'll just wait for shares to be received rather than incur the cost of borrowing. Please advise who we should speak with to have this removed.

Thanks

Rudy

126. On October 21, 2010, Delaney received a FINRA examination report that informed him that PFSI was violating Rule 204 with respect to closeouts of long sales of loaned securities.

- a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: On October 21, 2010, Delaney received a FINRA examination report that informed him that PFSI was violating Rule 204 with respect to **10 transactions** between February 1, 2010 through March 31, 2010.

c. Support:

- Exhibit 40 at pp. PENSON0624660, PENSON0624668

From: Brian Gover <[REDACTED]@PENSON.COM>  
Sent: Friday, October 22, 2010 12:49 PM (GMT)  
To: Gary Wiedman <[REDACTED]@[REDACTED].COM>  
Subject: FW: 2010 Pension Exit Meeting Report  
Attach: Final 2010 Pension Rpt.pdf; 000011.htm

From: Tom Delaney  
Sent: Thursday, October 21, 2010 6:46 PM  
To: Bill Yancey; Bart McCain; John Kenny; Mary Smith; Jay Hanville; Brian Gover; Holly Hasty; Mark Bell; Robert Henderson; Phil Pendergraft; Carl Gilmore  
Subject: Fwd: 2010 Pension Exit Meeting Report

Sent from my iPhone

Begin forwarded message:

From: "Li, Yue Ling" <[REDACTED]@[REDACTED].COM>  
To: "Tom Delaney" <[REDACTED]@[REDACTED].COM>, "Kimberly Miller" <[REDACTED]@[REDACTED].COM>  
Subject: 2010 Pension Exit Meeting Report

Hi Tom & Kim,

Attached is the 2010 Pension Exit Meeting report.

Thanks,

Yue Ling

9. The firm was not in compliance with Regulation SHO SEC Rule 204, and NASD Conduct Rule 3010.
- a) A review of CNS fail to delivers (FTD's) from February 1, 2010 through March 31, 2010, disclosed that there were a total of 86 CNS FTD's whereby the quantity amounts were unchanged, and the fails were outstanding for more than seven consecutive settlement days. The firm did not close-out the aged fails as required by the rule.
  - b) A review of ten CNS FTD's February 1, 2010 through March 31, 2010 whereby the quantity amounts had changed, disclosed the following:
    - 1) The firm failed to recall securities from stock loan or borrow securities to close out all 10 of these fails, which resulted in the fails being consistently outstanding beyond Trade date +4 for short sale FTD's and Trade date +6 for long sale FTD's.
    - 2) The firm did not adhere to the "Penalty Box" requirement by not placing the ten outstanding FTD securities in the "Penalty Box" as a result of its failure to comply with the close-out requirement.

127. Delaney was the compliance person responsible for Rule 204.

- a. Response: **Dispute** – accuracy of statement. The Division’s statement mischaracterizes the cited support. Additionally, the Division’s statement is an incomplete recitation of the record.
- b. Counterstatement: By virtue of his position as Chief Compliance Officer, Delaney was primarily responsible for ensuring compliance with Rule 204; however, he relied on the assistance of Compliance staff and the subject matter experts in the business units.
- c. Support:
  - Hasty Testimony

Q Well, in fact, Mr. Delaney was the person who was responsible for Rule 204; isn't that right?  
A Yes.

Q And he was the one who you expected would have the responsibility to review the adopting release, for instance, that accompanied Rule 204, and work with the business units to make sure that the information contained in the adopting release was being properly implemented; isn't that correct?

A Yes.

(Hearing- Day 7, 1769:25-1770:9, Nov. 4, 2014)

- Alaniz Testimony

Q What was the purpose of meeting with the Stock Loan department?

A The purpose of meeting with any department in this search, under these circumstances with the Stock Loan, was to ensure that I understood the rule completely. Not completely as -- completely as to what I was going to test.

Q All right. You've read the rule?

A I've read the rule.

Q So -- so you said that you met with him to make sure you understood it. How did meeting with him help you understand it?

A Well, Reg SHO -- Regulation SHO was new to me. The rule was new at the time. So since they were the business unit that dealt with this rule on a daily basis, I wanted to make sure that I understood it as I read it. As them being the individuals that would be applying this rule, I wanted to make sure we were on the same page so that I wasn't testing one thing when they thought I was testing another.

(Hearing-Day 3, 749:1-20, Oct. 29, 2014)

- Delaney Testimony

Q Who did you rely on?

A Various groups. So I had my own staff, of course, that I would rely on, as well as I would rely on the subject matter experts within the -- within the business.

Q When you say "subject matter experts," what does that mean to you?

A To me, that would be at Penson, lot of moving parts, a lot of -- a lot of departments with specific processes and procedures and things of that nature. And so those -- those leaders in that business group -- these would be generally the registered principals within those business groups -- would have -- would be those -- that key subject matter. I mean, they would know more -- they -- they would forget more about their department and how it operates than -- than I'd ever hope to know.

(Hearing-Day 5, 1220:20-1221:10, Oct. 31, 2014)

128. Delaney was the compliance person **responsible for** interfacing with Stock Loan.

- a. Response: **Dispute** -- accuracy of statement; incomplete recitation of the record.
- b. Counterstatement: Delaney was **one of** the compliance staff who interfaced with Stock Loan.
- c. Support:
  - Ex. 158 (Alaniz interacting with Stock Loan)

**From:** Eric Alaniz  
</O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=EALANIZ>  
**Sent:** Monday, July 26, 2010 7:40 AM  
**To:** Summer Poldrack <[REDACTED]@PENSON.COM>  
**Cc:** Tom Delaney <TD[REDACTED]@PENSON.COM>; Gover  
<[REDACTED]@PENSON.COM>; Jerry Reilly <[REDACTED]@PENSON.COM>;  
Holly Hasty <[REDACTED]@PENSON.COM>  
**Subject:** RE: \*\*\*REG SHO\*\*\*-

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Summer,

This is correct the Stock Loan account should be flat by the end of the day or have a surplus. Preferably this should be completed prior to or at market open. I will notify Rudy and Brian. Summer would you call me up when you have a second.

Thanks,

Eric



- Ex. 300 (Hasty and Miller interfacing with Stock Loan)

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**From:** Holly Hasty [H [REDACTED]@PENSON.COM]  
**Sent:** Friday, February 11, 2011 7:47 AM  
**To:** Tom Delaney; Mike Johnson  
**Cc:** Brian Hall  
**Subject:** RE: Reg SHO Buy-in vs Penalty Box

Agreed. We will want to make sure that we can demonstrate that the fail was the result of a long sale, which we can typically do by pulling the position sheets.

Penson Financial Services, Inc.  
1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201  
P: 214.953.3470 | F: 214.217.1646  
[www.penson.com](http://www.penson.com)

ON

*Building the Best Clearing and Execution Services Firm in the World*

**From:** Brian Hall <BHall@PENSON.COM>  
**Sent:** Friday, March 04, 2011 1:54 PM  
**To:** Kimberly Miller  
**Subject:** 204 Closeout Findings Response  
**Attachments:** FINRA Cycle Examination - DRAFT RESPONSES (2).doc

The portion I added to the document is below in blue. I have attached a copy of the updated version as well.

Thanks,  
Brian

- 13) The firm was not compliance with Regulation SHO SEC Rule 204 (Close-Out Requirement) and NASD Conduct Rule 3010 (Supervision).

A review of 10 CNS fail to delivers (FTD's) from the VISTA query fail report as of February 1, 2010 through March 31, 2010, disclosed the following:

- Nine(9) of the CNS FTD's were created by long sales, which required the firm to close out the fails by the morning of T+6, and one (1) CNS FTD was created by a short sale, which required the firm to close out the fail by the morning of T+4. The firm could not evidence that appropriate action was taken to close out all (1) fails.

*While the firm feels the procedures and policies around the handling of Reg Sho Rule 204 are generally effective we have taken steps to ensure that all items subject to Reg Sho Rule 204 are covered either by borrow or buy-in by the required date for each transaction type. We would note that of the items identified as being subject to buy in yet a buy-in did not occur we find 3 items which should have been bought in. The aggregate value of those transactions was <\$10,000.*

- The firm could not evidence adherence to the "Penalty Box" requirement, or evidence that a buy-in order was processed prior to the "market open" to comply with the close-out requirements of all ten on these fails.

*At the time of the examination period, the firm did not have procedures in place to adhere to the "penalty box" requirement. This gap was discovered in January 2010, independent from this audit, and procedures were developed and put in place in May 2010 to properly identify, and restrict for lending and locating purposes, cases where short sale closeouts were not performed by market open on T+4, borrows were arranged prior to market open on T+4 but did not settle, and long sale closeouts that did not occur on T+6.*

*In regards to the timing of long-sale closeouts, the firm does not believe it is industry practice to close out long sales prior to the market open on T+6. Not once has the firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the firm's borrowing counterparties will not accept a closeout price on a stock loan at the market open. Thus, the firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the firm at a competitive disadvantage and ultimately hinder the firm's ability to cover its customers' delivery obligations.*

- De La Sierra Testimony

A Okay. So on a -- one side of our room, Mike had his office. He had a sliding window and a door, so that was typically open. I was next to Mike. Next to my left was Brian Hall. We faced Lindsey Wetzig, Terry Ray, Dawnia Robertson, Marc McCain, Logan. Those are the operations. And then behind them was our two programmers, Matt Battaini and Dave Chen, and Dave faced the three compliance people that were in our group or in our area, I should say.

Q And who were those three compliance people?

A Holly Hasty, Kim Miller and Aaron McInerney.

(Hearing- Day 1, 223:23-224:8, Oct. 27, 2014)

- Miller Testimony

**Q** Now I would like to move briefly just to talk about the Stock Loan Department. This case is really about the Stock Loan Department at Penson, and I want to ask you about whatever personal knowledge you may have of the Stock Loan Department. And so let me just start with: From a physical proximity standpoint, wherever you officed, was that near the Stock Loan Department?

**A** Yes. For several years I sat within the Stock Loan Department.

**Q** And where was that? What floor was that?

**A** The 19th floor, I believe.

**Q** And how close physically in proximity to the department did you sit?

**A** Well, we sat on a row -- the four compliance people saw on a row, and they had all the desks on the other side of that row. So they were just on the other side of me. I just -- it was across from me.

**Q** So within just a couple of feet?

**A** Yes.

(Hearing – Day 11, 1575:19-1576:13, Nov. 10, 2014)

- Alaniz Testimony

**Q** What was the purpose of meeting with the Stock Loan department?

**A** The purpose of meeting with any department in this search, under these circumstances with the Stock Loan, was to ensure that I understood the rule completely. Not completely as -- completely as to what I was going to test.

**Q** All right. You've read the rule?

**A** I've read the rule.

**Q** So -- so you said that you met with him to make sure you understood it. How did meeting with him help you understand it?

**A** Well, Reg SHO -- Regulation SHO was new to me. The rule was new at the time. So since they were the business unit that dealt with this rule on a daily basis, I wanted to make sure that I understood it as I read it. As them being the individuals that would be applying this rule, I wanted to make sure we were on the same page so that I wasn't testing one thing when they thought I was testing another.

(Hearing-Day 3, 749:1-20, Oct. 29, 2014)

- Hasty Testimony

**Q** In fact, it is an error that Bill Yancey is listed as Mike Johnson's supervisor in any capacity?

**A** I would agree with that, yes.

....

**Q** Why do you believe that that is an error?

**A** I sat in the location where the Stock Loan folks were for a period of time. I mean, Mike Johnson is not a quiet person. He was very vocal about who he reported to and where he got his directions and how, if something were to come up, who he was going to take his orders from. And so looking at all of these documents is all well and good, but at the end of the day, my own

personal perception and observations of Mike Johnson and his own admission that he reported to Phil is what makes it clear to me.

**Q** So you would not be surprised that, in fact, in this trial, Mike Johnson testified that he was supervised by Phil Pendergraft?

**A** It would not surprise me at all.

**Q** Does the fact that an erroneous document was given to the regulators in any way change what the supervisory chain with Mike Johnson was in reality?

**MS. ATKINSON:** Objection, Your Honor.

**JUDGE PATIL:** Overruled.

**A** No.

(Hearing – Day 7, 1794:12-1795:18, Nov. 4, 2014)

129. Often when new rules came out PFSI's Compliance department would have meetings, analyze technologies, and develop a road map to ensure compliance.

a. Response: *No dispute.*

- Hasty Testimony

**Q** Ms. Hasty, what -- if you recall, can you discuss the steps that Penson's Compliance Department took when new rules and regulations were issued or changed?

**A** So typically new rules and regulations would come to us in a variety of different ways. Many of us were signed up for different types of alerts that came from the regulators themselves. Most of the SROs have the ability for you to sign up for a news feed or something along that line. And there are lots of different publications that come out on a regular basis that provide that information. So it was pretty well circulated. Once we received something and we had a chance to review it, oftentimes we would set off -- set up meetings with the different business owners that we felt like these particular rule changes or new rules would touch, and we would start working through the process of determining what procedures may need to be changed, what development effort, you know, the technology resources or people resources might be required, and -- and really try to lay out the road map for how we were going to meet certain compliance deadlines and making sure that we would be compliant at the time those rules came into effect. It wasn't uncommon for us to use working groups or put together, you know, groups of folks who met regularly that covered a lot of different business areas, just to make sure that everybody understood and was onboard with how we were going to implement a new rule or regulation.

(Hearing- Day 7, 1707:11-1708:16, Nov. 4, 2014)

**Q** I think that's what I wrote down. What is a working group? Can you explain that for us?

A So it was not uncommon at Penson for us to put together working groups of people from all various business units, including legal, including technology, including the business unit and compliance, to really focus on a particular issue. So if there was a new rule that might come out and we knew that we had a six-month implementation date we, would get a group of both dedicated business owners, oftentimes we would have a legal representative, there would be someone from compliance, there would be folks from technology, to really work through what updates the procedures needed to be made, what development or IT resources would be needed, what reports might need to be created, whether there was staffing that needed to be addressed, if there were forms or notifications to any of our documents that needed to be made. All of those things were things that we worked through in these working group.

(Hearing- Day 7, 1714:20-1715:14, Nov. 4, 2014)

130. In contrast, Delaney does not recall any meetings about the implementation of Rule 204.

- a. Response: *Dispute* – mischaracterizes testimony.
- b. Counterstatement: **Delaney testified that when 204T was implemented, he had meetings about the rule, but he does not remember specific meetings.**
- c. Support:
  - Delaney Testimony

**Q When 204T was implemented, do you remember if I had any meetings with people up the chain from you at the time that Rule 204T was implemented?**

A Yes.

**Q Yes, you did have meetings?**

A I believe we had meetings, yes.

**Q Do you recall any of those meetings?**

A Not a -- not meetings in specific, but I know, again, there was lots of -- there was communications going around. We were -- there was coordinating those communications and things of that nature.

Q Okay.

A Not -- and then again, notwithstanding the -- the earlier meeting that I had mentioned where -- around 204T where Mike Johnson and I -- not really -- I wouldn't classify as a meeting; much more as a hallway conversation about his -- his concern about the resistance to counter-parties.

THE COURT REPORTER: I'm sorry. About the what?

A Resistance from counter-parties.

BY MR. WASHBURN:

**Q But did you have more formal meetings than just that kind of hall walk-by that you described with Mr. Johnson?**

A With Mr. Johnson, no.

**Q Okay. With anyone?**

A I may have. I don't -- I'm not specifically remembering.

(Hearing- Day 5, 1238:15-1239:18, Oct. 31, 2014)

131. No technology was designed or modified to enable Stock Loan to comply with Rule 204T/204.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: Stock Loan’s Sendero system was reliable and accurate. It was modified in 2011 to resolve the conflict between the MSLA and Rule 204 compliance. Specifically, the Stock Loan department engaged in remediation efforts, including reworking the automated queries and reports in order to comply with Rule 204 close-out procedures.
- c. Support:
  - De La Sierra Testimony

Q: All right. We’ve talked for a minute -- for a while now about Sendero. What was your sense of Sendero’s accuracy, reliability?

A: I felt it was very reliable.

(Hearing-Day1, 234:22-25, Oct. 27, 2014)

- Wetzig Testimony

Q: And in your experience, was it -- did it seem to be an accurate system at telling you whose responsibility, whether it was a short or a long?

A: Yes. Sendero was a very accurate system.

(Hearing-Day 2, 365:14-17, Oct. 28, 2014)

Q: Do you have a sense of -- can you put that in a range of accuracy, how accurate it seemed to be?

A: I would say 95 percent.

(Hearing-Day 2, 374:18-20, Oct. 28, 2014) (discussing Sendero)

Q: Did there ever come a point in time where Sendero was reprogrammed to change when that recall was happening?

A: Yes.

Q: And -- and when -- to the best of your memory, about when did that occur?

A: I would say, maybe, 2010.

Q: Do you recall how the reprogramming worked? I mean, what happened? What -- what did you do to reprogram Sendero?

A: So our programmer, Matt Battaini, programmed Sendero so that we could see what we needed to recall on T+2 instead of T+3.

(Hearing-Day 2, 372:25-373:12, Oct. 28, 2014)

- Ex. 70

**Securities Lending Department**

- Daily reconciliation of all securities borrowed or arranged to borrow to close-out "fail to deliver" positions. Documentation completed daily and signed off by the department's Principal. Any security that fails to meet the "close-out" requirement should be reported to the Buy-In Department for inclusion of next day "buy-ins" and subject to the "Penalty Box" borrowing requirements of Rule 204.
- All securities that failed to meet the "close-out" requirement, as reported to you by the Buy-In Department, subject to the "Penalty Box" borrowing requirements of Rule 204.
- A complete review and re-work of the T+4 query/report for the possibility that short positions in other account types (i.e. inventory accounts) are being missed until automation of the T+4 report by the Buy-In Department is completed.
- All required "buy-ins" on T+4 and T+6 reports executed by PFSI only
- Please work with the Buy-In Department to facilitate any necessary recommendation(s).

The T+6 report will be reviewed and reworked as necessary for compliance with Rule 204 to ensure that all account(s) that may have been missed in the past are included in the report going forward. Executions are now being done at or before the market open.

132. The Compliance department never gave effective guidance to Stock Loan on how to comply with Rule 204.

- a. Response: *Dispute* – accuracy of statement; contrary evidence.
- b. Counterstatement: The Compliance department gave sufficient guidance to Stock Loan on how to comply with Rule 204.
- c. Support:
  - See exhibits cited for support in Response to Division's FOF 62.
  - Delaney Testimony

Q: You have Exhibit 378 in your binder. Do you see that document?

A: I do.

Q: And what is that?

A: That's an e-mail from Mark Fitterman, an attorney for Morgan Lewis, sent to me on Thursday, February 10th, 2011; subject, attorney-client privileged communication, Reg SHO.

Q: If you could go back to the first e-mail in this chain. Who is that e-mail from and who is it to?

A: The first e-mail is to Andy Koslow, with a copy to Holly Hasty, from me.

**Q: And if you were to look at -- so I think two of the last three paragraphs there, the second-to-last and third-to-last paragraphs, does that -- does that describe this dispute that you had with Mr. Johnson?**

A: The last three? It that what you said?

Q: Yeah, on Page 3 of this document. Does that describe the dispute?

A: Yes. I think that describes the dispute, yes.

Q: And accurately, as far as you're concerned?

A: Yes.

**Q: All right. And you sent that to Mr. Koslow, the general counsel?**

**A: I did.**

**Q: And then did you send it on after that to the attorneys at Morgan Lewis?**

**A: I did.**

(Hearing – Day 5, 1310:4-1311:6, Oct. 31, 2014)

- Alaniz Testimony

Q . . . All right. Now, you went over this quickly with Ms. Atkinson, but when you first met with Stock Loan, who was there?

A Rudy De La Sierra and Brian Hall.

Q Okay. And in the first meeting with them, did you discuss the rule?

A I discussed my interpretation of the rule.

Q And what did you tell them that you -- you understood the rule to require?

**A I understood the rule to require if there were any fails of T+4 or T+6, that the position in question must be bought in at -- prior or at market open.**

Q Okay. I don't want to belabor it too much, but fails would be a situation where there was -- a security was supposed to be delivered to CNS --

A Correct.

Q -- and for whatever reason, it wasn't?

A Correct.

Q And had to be bought in? Or was buying in the only way to cure a fail, to the best of your recollection?

A Buy in borrow the shares.

Q Okay. And you told them that needed to be done at or prior to market open on T+6 or T+4; is that correct?

A Correct.

Q And T+4 deals with short sales?

A Correct.

Q T+6 the long sales?

A Correct.

Q Okay. Did they -- and I guess you can talk about them individually or as a group. Did either of them mention to you a different interpretation?



A No, they did not. Brian Hall was silent. Rudy De La Sierra indicated that that was not his interpretation of the rule.

Q Okay. What did he tell you his interpretation was?

A He did not. He just stated that my interpretation was not the correct interpretation. So at that point, so there wouldn't be any, I guess, head butting or trying to, I guess, to avoid any type of confusion, I let them take the rule with them. I told them to read it, sleep on it, and the next day we would reconvene and we would decided what -- what they thought the understanding of the rule was.

Q Okay. So did that happen?

A Yes.

Q That next day meeting, what happened?

A The next morning, I was called up. I can't remember who called me up. I met with Brian Hall, Rudy De La Sierra, and they brought in Matt Butane and I went over with Doug Gorenflo. And as soon as we arrived, I asked them if they had time to read the rule. **And they said yes, and they did confirm that my interpretation of the rule was correct.**

Q Okay. At any point during that meeting, did they tell you that they -- that their operations were inconsistent with your interpretation of the rule?

A No.

(Hearing – Day 3, 750:5-752:14, Oct, 29, 2014)

- Stip. FOF 70 (“Members of Penson’s Stock Loan Department at all times knew that Rule 204T or 204 required them to close out all long sale transactions by market open at or before market open on T+6”).

133. In approximately August 2009, Delaney sent an e-mail out regarding Rule 204.

a. Response: *No dispute*.

134. The e-mail (Exhibit 125) simply referenced that close-outs needed to occur on T+6; it did not specify at what point during the day the close-out must occur.

a. Response: **Dispute** – Division’s statement mischaracterizes the exhibit and fails to provide important context about the exhibit.

b. Counterstatement: Exhibit 125 was copied almost word-for-word from a bulletin issued by Penson’s counsel. The bulletin from counsel referenced that closeouts needed to occur on T+6; it did not specify at what point during the day the close-out must occur. Both the Stock Loan and Buy-Ins Departments knew the Rule 204 close-out requirements.

c. Support:

- Delaney Testimony

Q Have you had a chance to compare the language in Exhibit 425A with the language in Exhibit

125?

A I have.

**Q Are they at all similar?**

**A They're nearly identical.**

Q Okay. What does that mean to you?

A That this was the -- this was the source information for which I took and made the larger 13 distribution in my communication.

**Q When you say, "they're largely identical," you mean, like, word-for-word you copied large portions of Exhibit 425A?**

**A I did.**

(Hearing- Day 5, 1256:5-17, Oct. 31, 2014)

- Ex. 425A

The final rule includes some modifications from the interim rule:

- **Early Close Outs Using Pre-Fail Credits.** Rule 204 continues to permit early close outs through the use of so called "Pre-Fail Credits." However, Rule 204 now provides that a broker-dealer may use either purchases or borrows to obtain the Pre-Fail Credits, rather than being limited to purchases. In addition, Rule 204 provides that a broker-dealer is only required to obtain Pre-Fail Credits to cover its open fail position, rather than having to cover the entire amount of its open short position.
- **Using Borrowed Shares to Close Out Fail Positions.** As noted above, Rule 204 continues to allow broker-dealers until T+6 to close out a fail position without becoming subject to the borrowing penalty if the fail position results from long sales or from bona fide market making activity. However, broker-dealers now may either borrow or purchase securities to close out those fail positions, rather than being limited to purchases.
- **Allowing Extended Close Out Period for All "Deemed to Own" Securities.** Rule 204 incorporates the provision of Rule 204T stating that fail positions resulting from sales of securities pursuant to Rule 144 under the Securities Act of 1933 must be closed out by no later than the beginning of regular trading hours on the 35th consecutive calendar day following Settlement Date. However, Rule 204 extends the application of that time frame beyond Rule 144 securities to all securities that a person is "deemed to own"

pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed.

- **Explicit Prohibition on Sham Close Outs.** Rule 204 now includes specific language to provide that a broker-dealer will not be deemed to have fulfilled the requirements of Rule 204 where the broker-dealer enters into an arrangement with another person to purchase or borrow securities as required by Rule 204, and the broker-dealer knows or has reason to know that the other person will not deliver securities to settle the purchase or borrow.

- Ex. 125

- (1) **Early Close Outs Using Pre-Fail Credits.** Rule 204 continues to permit early close outs through the use of so called "Pre-Fail Credits." However, Rule 204 now provides that a broker-dealer may use either purchases or borrows to obtain the Pre-Fail Credits, rather than being limited to purchases. In addition, Rule 204 provides that a broker-dealer is only required to obtain Pre-Fail Credits to cover its open fail position, rather than having to cover the entire amount of its open short position;
- (2) **Using Borrowed Shares to Close Out Fail Positions.** As noted above, Rule 204 continues to allow broker-dealers until T+6 to close out a fail position without becoming subject to the borrowing penalty if the fail position results from long sales or from bona fide market making activity. However, broker-dealers now may either borrow or purchase securities to close out those fail positions, rather than being limited to purchases;
- (3) **Allowing Extended Close Out Period for All "Deemed to Own" Securities.** Rule 204 incorporates the provision of Rule 204T stating that fail positions resulting from sales of securities *pursuant to Rule 144* under the Securities Act of 1933 must be closed out by no later than the beginning of regular trading hours on the 35th consecutive calendar day following Settlement Date. However, Rule 204 extends the application of that time frame beyond Rule 144 securities to all securities that a person is "deemed to own" *pursuant to Rule 200* of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed; and
- (4) **Explicit Prohibition on Sham Close Outs.** Rule 204 now includes specific language to provide that a broker-dealer will not be deemed to have fulfilled the requirements of Rule 204 where the broker-dealer enters into an arrangement with another person to purchase or borrow securities as required by Rule 204, and the broker-dealer knows or has reason to know that the other person will not deliver securities to settle the purchase or borrow.

- Gover Testimony

Q Who at PFSI knew about Rule 204(a) and the obligations to -- to close out that we just discussed? And I'll just throw it out. Did buy -- did the buy-ins department know that?

A Yes.

Q Did the Stock Loan department know that?

A Yes.

(Hearing – Day 1, 101:17-23, Oct. 27, 2014)

- De La Sierra Testimony

Q Mr. De La Sierra, were you aware of when the rule required close-outs of long sales?

A When 204T went into place?

Q Yes, sir.

A Yes.

Q What time did the rule require close-outs?

A Market open of T6.

(Hearing – Day 1, 202:6-14, Oct. 27, 2014)

- Johnson Testimony

Q And -- and your reading of the rule was that it required close-out by market open on T+6?  
A My reading of the rule as it pertained to long sales and CNS, yes.

(Hearing – Day 2, 536:3-6, Oct. 28, 2014)

135. The e-mail (Exhibit 125) did not discuss the conflict between the securities lending cycle and the rule. Nor did it provide any guidance on how Stock Loan should comply with the Rule's requirement to close-out at market-open T+6 in the face of counterparty refusal to be bought in at market-open T+6.

- Response: *Dispute* – Division's statement mischaracterizes the exhibit and fails to provide important context about the exhibit; Division's statement consists of impermissible argument in violation of the Post-Hearing Order.
- Counterstatement: Exhibit 125 was copied almost word-for-word from a bulletin issued by Penson's counsel. The bulletin from counsel referenced that closeouts needed to occur on T+6; it did not specify at what point during the day the close-out must occur. Both the Stock Loan and Buy-Ins Departments knew the Rule 204 close-out requirements.
- Support: See support cited in response to Division's FOF 134 above.

136. At the time of the August 2009 e-mail, Delaney was aware that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.

- Response: *Dispute* – contradictory testimony exists.
- Counterstatement: At the time of the August 2009 e-mail, Delaney **was not aware** that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.
- Support

- Delaney Testimony

Q . . . Prior to you seeing that FINRA exam response that we showed in Exhibit 89 a moment ago, had you ever had a conversation with anyone at Penson that left you with the understanding that Stock Loan wasn't closing out long sales of securities they had out on loan?

A No.

...

Did any conversation you ever had with Mr. De La Sierra leave you with the impression that Stock Loan wasn't complying with Rule 204?

A No

(Hearing – Day 5, 1307:9-14; 1307:24-1308:2, Oct. 31, 2014)

137. Delaney claimed that he paid close attention to Stock Loan's compliance with Rule 204. He claimed that "We tested. We tested and tested and tested and tested."

- a. Response: **Dispute** – mischaracterizes testimony. The Division's statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- b. Counterstatement: **In his investigative testimony, Delaney stated that the compliance department** paid close attention to Stock Loan's compliance with Rule 204. **He stated** that "We tested. We tested and tested and tested and tested."

- Exhibit 224 (Delaney Investigative Testimony) at p. 446, 14 – 19

14	A Well, we paid close attention, right? We tested.
15	We tested and tested and tested and tested. So it wasn't a
16	-- by no means blind-to-ignorance to the operations of
17	what's occurring there. We had specific testing that was
18	being put in place to check for it at T+6 and in the event
19	we were complying with T+6.

138. Delaney admitted that, in fact, the December 2009 testing was the only test testing Stock Loan, that the December 2009 testing did not test Stock Loan's compliance with the close-out requirements of Rule 204, and that the follow-up testing in June 2010 did not test Stock Loan at all.

- a. Response: **Dispute** – misleading and mischaracterizes testimony. The Division's statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- b. Counterstatement: Delaney **stated that he did not remember whether** the December 2009 testing was the only test testing Stock Loan, that the December 2009 testing did not test Stock Loan's compliance with the close-out requirements of Rule 204, and that the follow-up testing in June 2010 did not test Stock Loan at all. **Neither Delaney nor anyone else in the Compliance Department had any reason to believe Stock Loan was not complying with Rule 204.**

- c. Support:

- Alaniz Testimony

Q What about, did your test focus primarily on buy-ins -- on the buy-ins function?
A I didn't make -- yes, it did, but at the time, I didn't make any distinction between what I was going to focus on. It was just buy-in. The focus was to ensure that the rule was being adhered to.
Q Okay. And you constructed the test as best you could to -- to attempt to test that, correct?

**A Yes.**

(Hearing – Day 3, 745:15-23, Oct. 29, 2014)

- Delaney Testimony

Q . . . Mr. Alaniz's audit tested the buy-ins department. . . . do you believe that an audit of a department that did not test whether there were failures to close out on long sales of loaned securities could ever be a red flag about failures to close out long sales of loaned securities in the Stock Loan Department?

A No.

**Q . . . you did not see a nexus - -**

**A No**

(Hearing – Day 5, 1348:19-23, Oct. 31, 2014).

- Delaney Testimony

Q In fact, Mr. Delaney, the test in December of 2009 is the only test that tested Stock Loan's compliance with Rule 204; isn't that right?

**A I don't know that.**

Q Do you know of any other testing as you sit here today that tested Stock Loan's compliance with Rule 204?

A That was a long time ago. **There may have been a lot of testing in the quality control that was going on.**

Q As you sit here today, do you know of any other testing that showed that stock -- Stock Loan's compliance with Rule 204? It's just yes or no. Yes, you do know, or no, you don't know.

A As I -- right now in my present recollection, I don't know.

Q Okay. I think you testified yesterday that you, over the course of preparing for this case, have looked at thousands of documents. Is that what you said?

A I don't know if I said thousands, but it may have been hundreds.

Q Lots and lots of documents?

A Lots of documents.

Q Did you see anything in those documents that showed any other testing of Stock Loan's Rule 204 compliance?

**A I may have.**

Q Do you remember seeing any documents that showed that?

A As I sit here today, I don't have a recollection of any other testing.

Q Okay. Do you think if there was other testing, your counsel would have brought that to your attention?

A I don't know what my counsel would do.

Q Okay. And, in fact, as we've looked at rule -- at Exhibit 70 -- and you can look back at it, of course -- that didn't test Stock Loan's close-out compliance with Rule 204; isn't that right?

A It did not. To be more precise, it didn't test that process within Stock Loan that closes out. Whether it tested close-outs that came from -- that Stock Loan was involved in, I'm not sure. But I don't think this -- this particular matter at issue, of the process of the actual close-out that was

happening in Stock Loan, was tested in this particular test.

(Hearing- Day 3, 637:3-638:22, Oct. 29, 2014)

Q The follow-up test that you were just looking at, at Exhibit 85.

A It appears to have tested the buy-in department, yes.

Q Okay. It didn't test the Stock Loan department?

A Now, I'm sorry. We're back to 85?

Q **The follow-up testing, yes.**

A **The test is to Summer, Jerry and Brian, which are just in the buy-in department.**

(Hearing- Day 3, 636:2-636:11, Oct. 29, 2014)

- Gover Testimony

Q . . . you don't remember it, as you're sitting here, if you were asked about that back at the time the 3012 report came out, I take it you would have mentioned the Stock Loan issue if you knew about it, right?

A If I were aware of the Stock Loan issue, yeah.

Q You for certain would have brought that up?

A **If I were aware and had a belief that Stock Loan was not doing what they should have been doing, yes, I would have brought it up.**

(Hearing – Day 1, 155:18-156:1, Oct. 27, 2014)

- Yancey Prop. FOF 15 (“Penson’s Stock Loan Department and the Buy-Ins Department were separate departments, and a problem in one department did not suggest that there was an issue in the other department”) (and evidence cited therein)

139. At the time of the December 2009 audit of Rule 204 compliance issues, Delaney was aware that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.

- a. Response: *Dispute* – contrary evidence.
- b. Counterstatement: At the time of the December 2009 audit of Rule 204 compliance issues, Delaney **was not aware** that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.
- c. Support:

- Delaney Testimony

Q **Prior to you seeing that FINRA exam response that we showed in Exhibit 89 a moment ago, had you ever had a conversation with anyone at Penson that left you with the**

understanding that Stock Loan wasn't closing out long sales of securities they had out on loan?

A No.

...

Did any conversation you ever had with Mr. De La Sierra leave you with the impression that Stock Loan wasn't complying with Rule 204?

A No

(Hearing – Day 5, 1307:9-14, 1307:24-1308:2, Oct. 31, 2014)

140. Follow-up Rule 204 testing performed in June 2010 tested only Rule 204 compliance with close-outs of short sales, not long sales.

a. Response: *No dispute*

141. The follow-up testing should have tested a larger sample and tested the long sales which had the most problematic results.

a. Response: *Dispute* – mischaracterizes the testimony. The statement requires context in order to reflect the true nature of the testimony.

b. Counterstatement: **Poppalardo testified that Penson had a very robust testing process.** She also testified that, **hypothetically**, if a small sample showed a huge failure rate, she would have tested a larger sample and the part that was most problematic.

c. Support:

- Poppalardo Testimony

Q Again, in terms of your experience in the industry, did you have a chance to look at Penson Financial's system for enforcing its policies and procedures?

A I did.

Q And what was your opinion?

A I thought they had a very good -- a **very robust Series 12 testing process**. It was better than a lot that we've seen.

(Hearing-Day 8, 1995:2-10, Nov. 5, 2014)

Q Okay. You did testing and a small sample showed a huge failure rate. Would you test a larger sample?

A Absolutely.

Q Okay. And you would make sure that you tested the part that was most problematic, wouldn't you?

A Yes.

(Hearing- Day 8, 2035:14-21, Nov. 5, 2014)



142. **Delaney's** was responsible to make sure that PFSI had policies and procedures designed to prevent or detect violations of rules.

- a. Response: **No dispute**, except to correct typographical error.
- b. Counterstatement: **Delaney** was responsible to make sure that PFSI had policies and procedures designed to prevent or detect violations of rules.

143. It was important for Delaney to be honest and forthcoming with Yancey.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: **Yancey agreed that** he considered it important for Delaney to be honest and forthcoming with him.
- c. Support:
  - Yancey Testimony

Q You would rely on Mr. Delaney to help ensure the firm's compliance with rules and regulations?  
A Yes, sir.  
Q In fact, you specifically relied on Mr. Delaney to help ensure compliance with Reg SHO?  
A Yes, sir.  
Q And as I think we can all agree, Reg SHO includes Rule 204, correct?  
A Yes, sir.  
Q All right. **Mr. Yancey, would you consider it important for Mr. Delaney to be honest with you?**  
A Yes, sir.  
Q Forthcoming with you?  
A Yes, sir.  
Q Not mislead you?  
A Yes, sir.

(Hearing- Day 3, 879:19-880:9, Oct. 29, 2014)

144. If Delaney learned that associated personnel were not following the securities laws, he was required to take reasonable steps to investigate and report his findings to members of senior management where those persons reported.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 13 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 13 as set forth below.
- c. Support:

- Stip. FOF 13

FOF 13. As Penson's CCO, if Delaney learned that associated personnel were not following the securities laws, he was required to take reasonable steps to investigate and report his findings to members of senior management where those persons reported.

(See Order on Stipulations)

145. Delaney **had a duty** to inform Yancey if Delaney knew that PFSI was following industry practice rather than Rule 204.

- Response: **Dispute** – accuracy of statement. The Division's statement mischaracterizes Yancey's testimony and also calls for a legal conclusion.
- Counterstatement: **Yancey testified that he expected** Delaney to inform him if Delaney knew that PFSI was following industry practice **that was contrary to Rule 204.**
- Support:
  - Yancey Testimony

Q And whether PFSI was choosing to follow industry practice instead of the law would have been important to you as a CEO, wouldn't it?  
A Yes, sir.  
Q If you had known that Penson was following industry practice instead of the law, you would have taken that seriously, correct?  
A Yes, sir.  
Q You would have wanted to follow up on it?  
A Yes, sir.  
Q It's something you would try to put a stop to; is that fair?  
A Certainly try to provide clarity and resources to make sure it was done properly.  
Q And to make sure that Penson was following the law rather than industry practice, correct?  
A Yes. That's fair.  
Q Now, Mr. Yancey, **if Tom Delaney knew that Penson was following a perceived industry practice that was contrary to the requirements of Rule 204, that's something you would have expected him to tell you; is that right?**  
A Yes, sir.

(Hearing- Day 4, 940:20-941:17, Oct. 30, 2014)

146. Delaney never informed Yancey that PFSI was following a perceived industry practice rather than Rule 204.

- Response: **No dispute.**

147. Delaney claimed that after the December 2009 Rule 204 testing, he “required that representatives from each of the business units involved with closing out short sales were present to discuss the results and create accountability.”

- a. Response: Dispute – contrary evidence exists. The cited support is unreliable and reflects statements made in Delaney’s Wells Submission, not Delaney’s personal admissions. *See* Jan. 15, 2015 Order (noting that the Court is disinclined to rely upon the Wells submission of Thomas R. Delaney II because the Court has determined that the representations made therein are insufficiently reliable).
- b. Counterstatement: Yancey was told that Stock Loan and Mike Johnson’s presence was not necessary to discuss the December 2009 Rule 204 testing because the Rule 204 issues were a Buy-Ins department issue and all indications from the Security Lending department and the Buy-Ins department was that they were cooperating in remediating those issues.
- c. Support:
  - Delaney Testimony

**Q And in the January testing -- or in the January meeting, excuse me, you told Mr. Yancey that Stock Loan didn't need to come; is that right?**

A I think it was actually Eric Alaniz that said that. I don't -- I think -- we had -- in that meeting -- in that meeting with Mr. Yancey, normally what I would do is bring the subject matter experts in there so that as Mr. Yancey had specific questions about those issues, that he would have the subject matter there. I was the overall administrator of the -- of the process, but often I wouldn't be the best person to be able to deal with the details that Mr. Yancey may have, during his inquiry of that process, during those meetings. So I would often bring -- I might bring my AML folks. I might bring -- in this case, Mr. Alaniz was there, who conducted, specifically, the testing related to this particular issue. **And when Mr. Yancey -- when we reported out the issuing and Mr. Yancey's first reaction was, do I need to get Mike Johnson down here, I believe it was Eric that said, this is a buy-ins issue, and we have this -- we have -- and we're -- and we're dealing with the buy-ins department on it. If we need to get those folks in, we can get them in later.**

(Hearing, Day 2, 611:15-613:19, Oct. 28, 2014)

Q Okay. You said, There were specific meetings right following the testing. When we do quarterly, we would do the CEO certifications. And Mr. Alaniz and myself were in a -- were in the office with Mr. Yancey briefing him on the specific findings. He, at that point, had made mention of the fact that well, this was something we needed to get Mike Johnson in the office for when he saw those particular findings. **We, at that point in time, had explained that we didn't think at this point that there was a Stock Loan issue, that this was really appearing to be a buy-in issue.**

Did you give that testimony?

A I believe I did.

(Hearing- Day 2, 614:7-614:23, Oct. 28, 2014)

- Alaniz Testimony

Q Okay. And then with Rule 204, I presume we have an idea. That was that testing we were just looking at there, right?

A Correct.

Q Did you describe kind of the test that you -- that you had done at that point?

A Yes.

Q And what was the response?

A **Mr. Yancey's response was that we should bring in Michael Johnson to the conversation.**

Q And was there any response to that?

A I had a response.

Q What did you say?

A **I had told him that I didn't believe that was necessary. All indications from the security lending department and the buy-ins department was that they were cooperative in remediating those issues.**

(Hearing – Day 3, 762:16-763:7, Oct. 29, 2014)

148. In fact, Delaney admitted that he told Yancey that Stock Loan did not need to attend the first meeting discussing the December 2009 Rule 204 testing.

- a. Response: **Dispute** – contrary evidence. The cited support is unreliable and reflects statements made in Delaney’s Wells Submission, not Delaney’s personal admissions. *See* Jan. 15, 2015 Order (noting that the Court is disinclined to rely upon the Wells submission of Thomas R. Delaney II because the Court has determined that the representations made therein are insufficiently reliable).
- b. Counterstatement: Yancey was told that Stock Loan and Mike Johnson’s presence was not necessary to discuss the December 2009 Rule 204 testing because the Rule 204 issues were a Buy-Ins department issue and all indications from the Security Lending department and the Buy-Ins department was that they were cooperating in remediating those issues.
- c. Support: *See* support cited in response to Division’s Proposed FOF 147 above.

149. Delaney met with Yancey again on August 2, 2010 to discuss testing of PFSI’s compliance with Rule 204.

- a. Response: **Dispute** – Division’s statement is overbroad.
- b. Counterstatement: Delaney and Alaniz met with Yancey on August 2, 2010 to discuss **PFSI’s 3012 testing. Among other topics, Delaney and Alaniz discussed PFSI’s “completed follow-up exam of Reg SHO Rule 204.”**
- c. Support:

- Exhibit 92; 169

**From:** Eric Alaniz <[REDACTED]@PENSON.COM>  
**Sent:** Monday, August 02, 2010 3:22 PM  
**To:** Bill Yancey  
**Cc:** Tom Delaney; Erin Jones  
**Subject:** 2010-2011 Quarterly Annual Certification Meeting

**Importance:** High

Hi Bill,

Re: 2010-2011 Quarterly Annual Certification Meeting

I'd like to thank you today for the time you spent with Tom and me discussing our Compliance departments quarterly progress on the 3012 testing. Just as a quick recap of our meeting I have highlighted a few areas of discussion.

The Compliance department has completed a follow-up exam of Reg SHO Rule 204, the New Accounts department and out monthly Margin testing. As we discussed, I will forward to you two requirement reports one from PFSI and one from Ridge, test third party wires and follow up on the remediation of a few of the items discussed (i.e. cash straddles).

As always, we appreciate your feedback and guidance on past and future testing. If you should have any questions or concerns please do not hesitate to call me or tom.

- Stip. FOF 40 (Delaney's did not discuss Rule 204 violations related to long sales of loaned securities at his August 2, 2010 meeting with Yancey); 78 (December 2009 audit results related only to Buy-Ins); 43 (Yancey was not aware that Penson's Stock Loan Department was violating Rule 204)

150. It was important for Delaney to be honest and forthcoming with regulators.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: **Yancey agreed that** it was important for Delaney to be honest and forthcoming with regulators.
- c. Support:

- Yancey Testimony

**Q Would you also agree that, in your view, it's important for Mr. Delaney to be honest with regulators?**

A Yes, sir.

**Q To be forthcoming with regulators?**

A Yes, sir.

**Q To not mislead regulators?**

A Yes, sir.

(Hearing- Day 3, 880:10-880:16, Oct. 29, 2014)

151. On March 31, 2010, Yancey signed an “Annual Certification of Compliance and Supervisory Processes” for PFSI.

- a. Response: *No dispute*.

152. The Certification signed by Yancey attached a “NASD Rule 3012 Summary Report” (“Annual Report”).

- a. Response: *No dispute*.

153. The Annual Report, per Penson’s WSPs, was to discuss Penson’s “key compliance problems” for the period April 1, 2009 through March 31, 2010.

- a. Response: *No dispute*, although the Division’s statement is redundant of Stip. FOF 21 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 21 as set forth below.
- c. Support:
- Stip. FOF 21.

FOF 21.	On March 31, 2010, Delaney met with Yancey to discuss Yancey’s annual certification of Penson’s compliance testing procedures. As part of that certification, Penson’s Compliance Department prepared and presented <b>an Annual Report that, per Penson’s WSPs, was to discuss Penson’s “key compliance problems” for the period April 1, 2009 through March 31, 2010.</b> At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violations resulting from Buy-Ins’ procedures -- a compliance failure that Delaney later characterized as “massive,” “profound,” and “anomalous.”
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(See Order on Stipulations)

154. The Annual Report was also supposed to summarize the testing that had been conducted and the gaps found by that testing that had been presented to the CEO.

- a. Response: *Dispute* – accuracy of statement; contrary evidence.
- b. Counterstatement: The PFSI NASD Rule 3012 Summary Report states “[t]his report was prepared in accordance with NASD Rule 3012 to summarize the extensive testing of the Penson Financial Services, Inc. (“PFSI”) Written Supervisory Procedures for the time period of April 1, 2009 through March 31, 2010.” FINRA has provided guidance about the Rule 3012 Summary Report on its web site, which states that the Rule 3012 report “provides a summary of the test results and gaps found.”

c. Support:

- Exhibit 135 at PFSI1384375.000002

## **NASD Rule 3012 Summary Report**

***March 31, 2010***

### **Background**

This report was prepared in accordance with NASD Rule 3012 to summarize the extensive testing of the Penson Financial Services, Inc. ("PFSI") Written Supervisory Procedures for the time period of April 1, 2009 through March 31, 2010. A risk assessment of the PFSI's procedures was conducted by the NASD's Regulatory

- Exhibit 172 at p. 1



Industry Professionals > Industry Issues > Supervisory Control

### **Frequently Asked Questions**

#### **Rule 3012 Report**

**Q: Do the designated principals have any reporting requirements once they have completed testing and verifying the member's supervisory procedures?**

**A.** Yes. Rule 3012 requires the designated principals to submit, no less frequently than annually, a report to the member's senior management that details the firm's system of supervisory controls, the summary of the test results and any additional or amended supervisory procedures that have been created in response to those results.

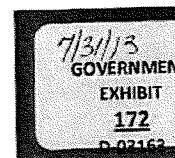
**Division's Exhibit**

172

**A.P. No. 3-15873**

In contrast, the Rule 3012 report is not a work plan (except to the extent it identifies amendments that need to be made), but, rather it is the work product of the result of the testing and verification of the sufficiency of the firm's scheme of supervisory policies and procedures. The Rule 3012 report:

1. details the manner, method and review for testing and verifying that a firm's system of supervisory policies and procedures are designed to achieve compliance with applicable rules and laws;
2. provides a summary of the test results and the gaps found; and
3. identifies the changes a firm made or will need to make to its supervisory procedures.



155. Delaney was responsible for the Annual Report.

- a. Response: *Dispute*. The Division's statement is redundant of Stip. FOF 45 previously stipulated to by all parties. There is no basis for a separate finding of fact.
- b. Counterstatement: Stip. FOF 45 as set forth below.
  - i. In the alternative, Yancey disputes the statement for accuracy. The Division's statement should be amended as follows:

Delaney, with assistance from others, was responsible for the contents of the 3012 Summary Report, appended to the Annual CEO Certification.

c. Support:

- Stip. FOF 45

FOF 45.	<p>Penson's WSPs, effective as of March 31, 2010, contained a section titled "Annual CEO Certification (RULE 3130): CEO and CCO Mandated Meeting." Those procedures identified Yancey, as CEO/President, and Delaney, as CCO, to be the relevant Designated Supervisory Principals. The procedures required as follows: <b>"The CCO will prepare and provide the CEO (or equivalent officer) with an Annual Report that includes a review of [Penson]'s Supervisory System and Procedures and key compliance issues.</b> The CCO will meet with the CEO to discuss and review the report and will meet at other times, as needed, to discuss other compliance matters." The procedures further required Yancey to certify, among other things, that "[c]ompliance processes are evidenced in a written report reviewed by the CEO, CCO, and other appropriate officers and submitted to the Board of Directors and Audit Committee, if any."</p>
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(See Order on Stipulations)

- Exhibit 135 at p. PFSI1384375.000002

received for the various business units within the firm.

This report was prepared to accompany the 2010 Annual Certification of Compliance and Supervisory Processes as required by FINRA Rule 3130. Tom Delaney, the CCO of PFSI is the individual responsible for ensuring that the report meets the requirements of the rules. Tom Delaney is furthermore the individual who has been designated as having the responsibility to review and monitor the compliance with NASD Rule 3012 and FINRA Rule 3130 to ensure that the requirements under these rules are met. Furthermore, Tom Delaney has adequate knowledge of the following:

- Delaney Testimony

**Q** Okay. And at Penson, you were responsible for contents of the 3012 report; isn't that right?

**A** I was.

(Hearing- Day 3, 673:18-673:20, Oct. 29, 2014)

- Yancey Testimony

**Q** Who prepares it?

**A** The Chief Compliance Officer.

**Q** At this time, who was the Chief Compliance Officer?

**A** Tom Delaney.

**Q** And who decides what to include on this Summary Report?

**A** Tom Delaney.

**Q** Is it his judgment alone about what to include?

**A** I believe that Tom takes input from the staff, from the department heads, so ultimately, it is his decision, but I think he take inputs.

(Hearing- Day 7, 1886:17-1887:4, Nov. 4, 2014)

156. The Annual Report was a key document in FINRA examinations.

- a. Response: *No dispute.*

157. The Rule 3012 Summary Report contained a section describing “[t]he firm’s key compliance efforts to date.”

- a. Response: *No dispute.*

- Ex 135 PFSI1384375.000003

- The firm's compliance efforts to date

158. The Rule 3012 Summary Report also contained a section noting “[t]he identification of any significant compliance problems.”

a. Response: *No dispute*.

- Ex 135 PFSI1384375.000004

- The identification of any significant compliance problems

159. Alaniz created the template for the Annual Report, and would put in a few items for discussion. Alaniz would then send the Annual Report to Delaney to complete. Delaney determined what would be listed as significant compliance problems.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: Alaniz created the template for the **3012 Summary Report**, and would put in a few items for discussion. Alaniz would then send the report to Delaney to complete. Delaney **made the final determination on** what would be listed as a significant compliance problem.

c. Support:

- Alaniz Testimony

Q Okay. I would like you to look, if you would, please, at Exhibit 135. And I would like you to look at the report that is attached to it. And I just want you to tell me if you see your testing that was -- your Rule 204 testing that you did at the end of 2009, whether you see that in the report, the **3012 Summary Report**.

A I do not.

Q Who decided what was put into that report?

A Initially, I would create the template. I would put in a few items that we would discuss. And from there, I would send it to Tom Delaney to complete.

Q Okay. So who was it that decided whether items would be listed as significant compliance problems?

A I would ask Tom Delaney on that.

(Hearing- Day 3, 719:2-719:15, Oct. 29, 2014)

- Yancey Testimony

Q Who prepares it?  
A The Chief Compliance Officer.  
Q At this time, who was the Chief Compliance Officer?  
A Tom Delaney.  
**Q And who decides what to include on this Summary Report?**  
**A Tom Delaney.**  
**Q Is it his judgment alone about what to include?**  
**A I believe that Tom takes input from the staff, from the department heads, so ultimately, it is his decision, but I think he take inputs.**

(Hearing- Day 7, 1886:17-1887:4, Nov. 4, 2014)

160. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference ongoing, willful Rule 204(a) violations relating to long sales of loaned securities by Stock Loan.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 22 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 22 as set forth below.
- c. Support:
  - Stip. FOF 22

FOF 22. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference ongoing, willful Rule 204(a) violations relating to long sales of loaned securities by Stock Loan.

(See Order on Stipulations)

161. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference the Rule 204 testing conducted by Eric Alaniz in December 2009, the results of which Delaney later characterized as "massive," "profound" and "anomalous."

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 21 and 22 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 21 and 22 as set forth below.
- c. Support:
  - Stip. FOF 21, 22

FOF 21.	On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Penson's compliance testing procedures. As part of that certification, Penson's Compliance Department prepared and presented an Annual Report that, per Penson's WSPs, was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violations resulting from Buy-Ins' procedures -- a compliance failure that Delaney later characterized as "massive," "profound," and "anomalous."
FOF 22.	Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference ongoing, willful Rule 204(a) violations relating to long sales of loaned securities by Stock Loan.
(See Order on Stipulations)	

- Exhibit 135

162. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference Rule 204 at all.

- a. Response: **Dispute** – accuracy of statement; overly broad. The evidence cited by the Division does not support statement offered.
- b. Counterstatement: Delaney's March 31, 2010 Annual Summary Report appended to Yancey's CEO certification did not **explicitly** reference Rule 204; **the Summary Report stated that all 3012 Audit documentation, which included the Rule 204 audit, was available for review by the regulators.**
- c. Support:
  - Alaniz Testimony

Q: I mean, did you -- did you shred them as soon as you were done?  
 A: No, I would put all my documentation in folders and keep them there.  
 Q: And why -- why is it that you'd keep them there?  
 A: Well, they were able to be reviewed by the regulators, FINRA specifically.  
 Q: Okay. So FINRA can come in and ask for it and you –  
 A: Exactly.  
 Q: Did that ever happen when you were at Penson?  
 A: Yes.

(Hearing-Day 3, 804:12-805:3, Oct. 29, 2014) (discussing 3012 test results)

- Ex. 135 (stating that 3012 test results were "available in the Compliance Department").

163. Delaney would have expected some reference to Rule 204 to be in the Annual Report.

- a. Response: **Dispute** – accuracy of statement; evidence exists that contradicts Division's statement.
- b. Counterstatement: The Rule 204 testing was not expressly mentioned in the Summary Report because none of the 3012 tests conducted for that year were included because both Delaney and Alaniz believed the issues with Rule 204 were being remediated.
- c. Support:
  - Delaney Testimony

Q And after the audit, I think you testified earlier there was some remediation?

A There was.

Q Or maybe you didn't testify earlier. Maybe I'm misremembering.

A I think I recall I did.

**Q Had the remediation begun by the date of this letter?**

**A It absolutely had begun.**

(Hearing- Day 5, 1269:12-20, Oct. 31, 2014)

Q: And you would have expected it to be in the Summary Report; isn't that correct?

A: No.

(Hearing – Day 3, 677:22-24, Oct. 28, 2014)

Q: And the December audit, which we've seen was -- you believe was the focus of prompt remediation, was not explicitly listed as an item in that Summary Report; do you agree with that?

A: I do.

**Q: Why was it not specifically identified?**

**A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report.**

(Hearing – Day 5, 1360:25-1361:10, Oct. 31, 2014)

Q: How many different tests do you recall having been run during that cycle, if you know?

A: I don't know, but it was a lot.

**Q: ... Were the specific results of any of those tests disclosed in this Summary Report?**

**A: No.**

**Q: Not any of the tests?**

**A: Not any of the tests.**

(Hearing – Day 5, 1303:8-18, Oct. 31, 2014)

- Alaniz Testimony

**Q And so while you had a test that showed a problem with that buy-ins function, I think we saw that you had already been getting preliminary results back from, say, Summer Poldrack saying that things were getting better; is that about right?**

**A Yes.**

(Hearing – Day 3, 793:24-794:4, Oct. 29, 2014)

Q: And in filling out this form, do you recall if you put those 3012 test results in?

A: No. . . .

**Q: Okay. I suppose you could have if you thought they were -- if you considered them to be that important, right?**

**A: Yes**

(Hearing – Day 3, 826:13-21, Oct. 29, 2014)

Q: If you had wanted that to be included, would you have suggested that to Mr. Delaney?

A: I believe we definitely would have had a discussion about it. I don't see why. . . it would have been an issue with him. . . .

**Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it?**

**A: Yes.**

(Hearing – Day 3, 858:7-23, Oct. 29, 2014)

**Q: And you said earlier none of your 3012 testing for the year was included in that, right?**

**A: Correct**

(Hearing – Day 3, 857:19-21, Oct. 29, 2014)

164. Other topics that were the subject of compliance testing at PFSI were discussed in the Annual Report.

- a. Response: *Dispute* – contrary testimony.
- b. Counterstatement: Alaniz and Delaney testified that none of the 3012 tests conducted for that year were explicitly included in the Summary Report.
- c. Support:
  - Alaniz Testimony

**Q: And you said earlier none of your 3012 testing for the year was included in that, right?**

**A: Correct**

(Hearing-Day 3, 857:19-21, Oct. 29, 2014)

**Q: And in filling out this form, do you recall if you put those 3012 test results in?**

**A: No. . . .**

Q: Okay. I suppose you could have if you thought they were -- if you considered them to be that important, right?

A: Yes.

(Hearing-Day 3, 826:13-21, Oct. 29, 2014)

Q: If you had wanted that to be included, would you have suggested that to Mr. Delaney?

A: I believe we definitely would have had a discussion about it. I don't see why. . . it would have been an issue with him. . . .

Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it?

A: Yes.

(Hearing-Day 3, 858:7 – 858:23, Oct. 29, 2014)

• Delaney Testimony

**Q: How many different tests do you recall having been run during that cycle, if you know?**

**A: I don't know, but it was a lot.**

**Q: . . . Were the specific results of any of those tests disclosed in this Summary Report?**

**A: No.**

**Q: Not any of the tests?**

**A: Not any of the tests.**

(Hearing-Day 5, 1303:8-18, Oct. 31, 2014)

Q: And you would have expected it to be in the Summary Report; isn't that correct?

A: No.

(Hearing-Day 3, 677:22-24, Oct. 29, 2014)

Q: And the December audit, which we've seen was -- you believe was the focus of prompt remediation, was not explicitly listed as an item in that Summary Report; do you agree with that?

A: I do.

Q: Why was it not specifically identified?

A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report.

(Hearing-Day 5, 1360:25-1361:10, Oct. 31, 2014)

165. All of the items in the Rule 3012 Summary Report's identification of significant compliance problems are items that were being remediated.

- a. Response: *Dispute* – accuracy of statement; overly broad.
- b. Counterstatement: **Yancey testified that it appeared that all of the items listed under the subheading “identification of any significant compliance problems” on page 5 of the March 31, 2010 NASD Rule 3012 Summary Report are items that were being remediated.**
- c. Support:
  - Ex. 135 at pp. 5-6

prohibited activity governed by ethical behavior.

- The identification of any significant compliance problems
  - **INSITE Remediation Efforts**: In early 2009, PFSI began sending automated e-mail notifications to multiple personnel on a daily basis regarding the transmission status of the INSITE upload. These notifications ensure that personnel within the firm are notified of any problems with the transmission by 9:00 am, giving the Firm ample time to correct any technical issues and upload the file once more. In addition, in the FIRM's continuing effort to improve its processes and data integrity, a complete review of MPID coding for all offices have been reviewed for accuracy. Finally, the FIRM is in the process of finalizing the coding for reports detailing all of the information transmitted for each of the 23 data points.
  - **Retama Development Corporation Series B municipal bonds Remediation Efforts**: PFSI has agreed to no longer allow margin value to its customers for the Retama bond, and issued a maintenance call to the affected clients.



- **Renaissance Securities Ltd. A foreign broker/dealer**  
**Remediation Efforts:** PFSI will be terminating its relationship with this non-US broker-dealer entities affiliated with Renaissance by the end of the first quarter of 2010.
- **Cycle Examination #20080116158 Remediation Efforts:** PFSI takes all Regulatory Examinations as significant and as such will remediate as required by the Securities industry.

- Yancey Testimony

Q I want to look at the Summary Report itself. It's a couple of pages in. And, Mr. Yancey, I specifically want to look at the third page of the Summary Report. It's Bates Number 004 at the bottom. And you see a bullet point that says: The identification of any significant compliance problems. Do you see where I am?

A Yes, I do.

...

Q So we can agree that this report's identification of significant compliance problems, all of them are things that are being remediated, things where there are remediation efforts; fair?

A Fair.

(Hearing- Day 7, 1921:15-1922:18, Nov. 4, 2014)

166. The Annual Report referenced “exception and remediation tracking.” In May, 2010, FINRA requested the remediation tracking logs related to the CEO certification. The log provided to FINRA did not mention Rule 204T, Rule 204, or Alaniz’ testing of Rule 204 compliance.

- a. Response: **Dispute** – accuracy of statement; incomplete statement.
- b. Counterstatement: The Annual Report referenced “exception and remediation tracking.” The Exception and Remediation Tracking Log only tracked remediation of exceptions from the 2009 FINRA exam, not the 3012 internal audit results. Alaniz separately made available all 3012 testing materials, including the Rule 204 test results.
- c. Support:
  - Ex. 135 at p. PFSI1384375.000006

### Testing Plan

The PFSI testing plan consists of three components that were executed throughout the certification year. Those components are:

1. Identification, scope and prioritization of issues and areas to be tested (attached)
2. Execution and documentation of testing (available in the Compliance dept.)
3. Exception and remediation tracking (attached)

- Delaney Testimony

Q: Could you read just that whole section for us.

A: 'The PFSI testing plan consists of three components that were executed throughout the certification year. Those components are: Identification, scope and prioritization of issues and areas to be tested (attached); execution and documentation of testing (available in the Compliance Department); exception and remediation tracking (attached).'

(Hearing-Day 5, 1303:24-1305:7, Oct. 31, 2014)

- Alaniz Testimony

Q: I mean, did you -- did you shred them as soon as you were done?

A: No, I would put all my documentation in folders and keep them there.

Q: And why -- why is it that you'd keep them there?

**A: Well, they were able to be reviewed by the regulators, FINRA specifically.**

**Q: Okay. So FINRA can come in and ask for it and you --**

**A: Exactly. Q: Did that ever happen when you were at Penson? A: Yes.**

(Hearing-Day 3, 804:12-805:3, Oct. 29, 2014)

- Ex. 135 (stating that 3012 test results were "available in the Compliance Department").
- Ex. 194

**To:** 'Hill, Marvin '[Marvin. [REDACTED]@finra.org]  
**From:** Kimberly Miller  
**Sent:** Tue 5/11/2010 2:15:52 PM  
**Importance:** Normal  
**Subject:** FINRA Request - CEO Certification Records  
[Operational's Remediation Tracking Log Updated 03-30-2010.docx](#)  
[2009-2010 AML Remediation Tracking Log Updated 4-27-2010.doc](#)

Attached are the logs requested below. The binders have been put in your conference room.



logo-for-signature-2

Penson Financial Services, Inc.  
1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201  
P: 214.953.3363 | F: 214.217.5090  
[www.penson.com](http://www.penson.com)

*Building the Best Clearing and Execution Services Firm in the World*

**From:** Eric Alaniz  
**Sent:** Tuesday, May 11, 2010 1:01 PM  
**To:** Kimberly Miller  
**Subject:** RE: FINRA Request

Here is the following info for bullet point one. These are update periodically.

- Per CEO certification Please provide listing of internal and external audits tracked by the compliance department.

For bullet point 2 I'll bring over in a few minutes.

Eric

**From:** Kimberly Miller  
**Sent:** Tuesday, May 11, 2010 11:32 AM  
**To:** Eric Alaniz  
**Cc:** Tom Delaney  
**Subject:** FINRA Request

FINRA has requested the following items relating to the CEO Certification...

- Per CEO certification Please provide listing of internal and external audits tracked by the compliance department.
- Per CEO certification report, please provide the binders with noted exceptions.

167. On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Penson's compliance testing procedures. As part of that certification, Penson's Compliance department prepared and presented an Annual Report that, per Penson's WSPs, was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December

2009 audit showing the Rule 204(a) violation rate resulting from Buy-ins' procedures – a compliance failure that Delaney later characterized as “massive,” “profound” and “anomalous.”

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 21 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 21 as set forth below.
- c. Support:
  - Stip. FOF 21

FOF 21. On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Penson's compliance testing procedures. As part of that certification, Penson's Compliance Department prepared and presented an Annual Report that, per Penson's WSPs, was to discuss Penson's “key compliance problems” for the period April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violations resulting from Buy-Ins' procedures -- a compliance failure that Delaney later characterized as “massive,” “profound,” and “anomalous.”

(See Order on Stipulations)

168. Beginning in November 2008, OCIE conducted a review of PFSI's Rule 204T procedures. In October 2010, OCIE issued Penson a deficiency letter reporting that OCIE had found Rule 204T(a) violations. The findings reported to Penson in the deficiency letter included findings that Penson had violated Rule 204T in connection with short sales.


- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 28 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 28 as set forth below.
- c. Support:
  - Stip. FOF 28

FOF 28. Beginning in November 2008, OCIE conducted a review of Penson's Rule 204T procedures. In October 2010, OCIE issued Penson a deficiency letter reporting that OCIE had found Rule 204T(a) violations. The findings reported to Penson in the deficiency letter included findings that Penson had violated Rule 204T in connection with short sales.

(See Order on Stipulations)

169. The OCIE exam **concerned** close-outs of long sales as well as short sales.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: The OCIE exam, **which was initiated by letter on Nov. 6, 2008 and lasted two years, included inquiries** regarding close-outs of long sales as well as short sales.
- c. Support:
  - Ex. 752

 <b>OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS</b>	<b>UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549</b>	<b>Yancey Exhibit 752 A.P. No. 3-15873</b>
<p style="text-align: center;">November 6, 2008</p> <p>Mr. Scott Fertig Chief Compliance Officer [REDACTED]</p> <p>RE: Examination Regarding Regulation SHO</p>		

- Ex. 539

<b>From:</b> Magyar, Laura J. [REDACTED] <b>Sent:</b> Thursday, March 5, 2009 1:47 PM <b>To:</b> Doug Gorenflo [REDACTED] <b>Cc:</b> Holly Hasty [REDACTED] <b>Subject:</b> RE: [REDACTED]	<b>Yancey Exhibit 539 A.P. No. 3-15873</b>
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**Staff's questions for the 3/5/09 call concern those documents provided to Staff in response to its January 1, 2009 document request, #2, Exhibit B.**

19) #14: Account appears to buy 50000 net shares long on 10/13/2008 (100000 long/50000 short). Explain trading that supports buy-in. Also, note on 643 indicates “have stok will DTC tomorrow morning.” Explain.

22) #40: Explain trading on 10/27/08 for buy-in of 17,196 shares of RBCAA by account 16030413 (account appears to buys long and short)

- Hasty Testimony

Q Was OCIE on site for this exam at all?

A They were.

Q What do you recall about that?

A I remember that they came on and had a relatively small team. I believe it was five or six people, and I think they stayed for a week.

Q What happened after they left?

A After they left, then we just **continued for the next two years**, on and off, responding to requests, answering questions, setting up meetings, and generally just continuing on with the regular exam cycle.

(Hearing-Day 7, 1731:12-22, Nov. 4, 2014)

Q This is Person's **final exam response** in connection with the Reg SHO OCIE exam. It's a letter to Ms. Magyar dated **November 24th, 2010**. Are you familiar with this document?

A Yes.

(Hearing-Day 7, 1737:5-9, Nov. 4, 2014)

170. Moreover, PFSI represented to OCIE that there was **no report** that monitored **close-outs of long sales of loaned securities**.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: PFSI represented to OCIE that there was no **specific report** that monitored **sales marked long in type 2 accounts**.
- c. Support:
  - Exhibit 204 at p. 13

▪ What report monitors sales that are marked long in type 2 accounts?

**There is no specific report for this.**

171. On November 15, 2010, Kim Miller sent Delaney a draft of a response to deficiency letter arising from an OCIE exam.

a. Response: *No dispute*.

172. On November 19, 2010, Delaney replies to Miller, saying “attached is my redraft....”

a. Response: *No dispute*.

173. Delaney reviewed and edited PFSI’s response to Item No. 5.

a. Response: *No dispute*.

174. The language as edited by Delaney appeared in the letter submitted to OCIE on November 24, 2010. The letter did not disclose that PFSI’s Stock Loan was not able to comply with Rule 204, nor did it acknowledge the disastrous Rule 204 test results from December 2009 and June 2010. Instead the letter averred that “the processes employed to close-out positions that were allegedly in violation of rule 204T were effective and performed as designed.”

a. Response: *Dispute* – accuracy of statement; incomplete recitation of the record. The Division’s statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).

b. Counterstatement: The language as originally authored by Brian Gover, and as edited by Delaney, appeared in the letter submitted to OCIE on November 24, 2010. The letter stated that “the processes employed to close-out positions that were allegedly in violation of rule 204T were effective and performed as designed.”

c. Support:

- *See* Stip. FOF 30 (language in Gover’s November 8, 2010 draft response), 61 (Gover believed the language he authored was accurate both at the time he drafted it and as of the date that he testified at the final hearing)
- Alaniz Testimony

Q I'll just represent to you that S+1 is settlement plus one, which is the same as T+4. Based on your remediation plans that you had done, **did you believe that by November 2010, the firm's programs were effective and reasonably designed to close out short sales in --**  
A Yes.

(Hearing-Day 3, 828:23 – 829:4, Oct. 29, 2014)

- Hasty Testimony

**Q Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover's statement that "Penson's processes and procedures were effective and performed as designed," do you believe that was truthful and accurate?**

**A Yes.**

**Q Do you have any reason to believe that Mr. Gover's statement was inaccurate?**

**A No.**

**Q Misleading?**

**A No.**

(Hearing-Day 7, 1738:25 – 1739:10, Nov. 4, 2014)

Q Okay. And I believe Michael pulled back up the language from 101. That's the final response. Looking again at the language in the final response, "Penson believes that," do you believe that his -- Mr. Gover's statement that, "Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of Rule 204T were effective and performed as designed." Do you believe that that was truthful and accurate?

**A Yes.**

**Q Do you have any reason to believe that Mr. Gover's statement was inaccurate or misleading?**

**A No.**

(Hearing-Day 7, 1739:11-23, Nov. 4, 2014)

- Delaney Testimony

**Q: What changes did you make?**

**A: I -- I added that Penson believes -- where Brian had originally crafted 'Penson feels that the processes and procedures employed,' I added the word 'reasonable' in front of processes and removed the term 'procedures.' And --**

**Q: I suppose -- I suppose we ought to know that you put, 'Penson believes,' and he put, 'Penson feels.'**

**A: I did. I did change 'feels' to 'believes.'**

**Q: Were you attempting -- to the best of your recollection, were you attempting to change the meaning of this at all?**

**A: Absolutely not.**



(Hearing-Day 5, 1284:1-16, Oct. 31, 2014)

Q Let me do that. Why? Why don't you think this is inconsistent?

A Penson -- Eric's testing results were part of a compliance process of testing policies and procedures, and the fact that you find errors in testing -- in testing results is what you expect when you have a good testing regime. I would maybe worry more if he didn't find any errors at that point.

And certainly, I had no indicia of any other processes going on beyond what was already being tested and reported back on, and **we were remediating and we were -- and there were reports of remediating coming back in. I had business unit leaders telling me, we've got -- we've got this -- these -- sorry -- we've got these reasonable processes in place.**

**So there was just no -- there was nothing in that response, where Brian reports in, that would have somehow triggered to me that there was something inconsistent with what Eric was reporting.**

(Hearing-Day 5, 1285:5-23, Oct. 31, 2014)

175. Delaney admitted that the language in the OCIE letter was inconsistent with the Rule 204 testing Alaniz conducted in December 2009 and June 2010.

a. Response: **Dispute** – contrary testimony.

b. Counterstatement: Delaney, Hasty, and Alaniz testified that the language in the OCIE letter **was not inconsistent** with the Rule 204 testing Alaniz conducted in December 2009 and June 2010.

c. Support:

- Delaney Testimony

Q The sentence that reads, "Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effective and performed as designed;" do you see that?

A I do.

Q You covered that issue with your counsel, Mr. Washburn, earlier today; did you not?

A I did.

Q Now, it is that sentence that the Division alleges was your most significant act of concealment. Do you feel like that sentence was false?

A No.

**Q Do you feel like that sentence was misleading?**

A No.

**Q Do you feel like that sentence was wrong, confusing or unclear?**

A No.

(Hearing-Day 5, 1365:5-21, Oct. 31, 2014)

Q Do you recall -- well, do you recall being asked by Ms. Atkinson on cross-examination if you believed that the response that we're seeing here in Exhibit 101 was inconsistent with Mr. Alaniz's examination results? Do you recall being asked that?

A I -- I believe I remember that, yes.

Q And what did you say about whether you thought it was inconsistent?

A That I didn't think it was inconsistent with the results.

Q And did she ever ask you why you didn't think it was inconsistent?

A She did not.

Q Let me do that. **Why? Why don't you think this is inconsistent?**

A Penson -- Eric's testing results were part of a compliance process of testing policies and procedures, and the fact that you find errors in testing -- in testing results is what you expect when you have a good testing regime. I would maybe worry more if he didn't find any errors at that point.

And certainly, I had no indicia of any other processes going on beyond what was already being tested and reported back on, and **we were remediating and we were -- and there were reports of remediating coming back in. I had business unit leaders telling me, we've got -- we've got this -- these -- sorry -- we've got these reasonable processes in place.**

**So there was just no -- there was nothing in that response, where Brian reports in, that would have somehow triggered to me that there was something inconsistent with what Eric was reporting**

(Hearing-Day 5, 1284:17-1285:23, Oct. 31, 2014)

- Hasty Testimony

**Q Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover's statement that "Penson's processes and procedures were effective and performed as designed," do you believe that was truthful and accurate?**

**A Yes.**

**Q Do you have any reason to believe that Mr. Gover's statement was inaccurate?**

**A No.**

**Q Misleading?**

**A No.**

(Hearing-Day 7, 1738:25 – 1739:10, Nov. 4, 2014)

Q Okay. And I believe Michael pulled back up the language from 101. That's the final response. Looking again at the language in the final response, "Penson believes that," do you believe that his -- Mr. Gover's statement that, "Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of Rule 204T were effective and performed as designed." Do you believe that that was truthful and accurate?

A Yes.

**Q Do you have any reason to believe that Mr. Gover's statement was inaccurate or misleading?**

**A No.**

(Hearing-Day 7, 1739:11-23, Nov. 4, 2014)

- Alaniz Testimony

Q I'll just represent to you that S+1 is settlement plus one, which is the same as T+4. Based on your remediation plans that you had done, **did you believe that by November 2010, the firm's programs were effective and reasonably designed to close out short sales in --**

**A Yes.**

(Hearing-Day 3, 828:23 – 829:4, Oct. 29, 2014)

176. It is not possible to reconcile the statement concerning Rule 204 in the letter to OCIE with Alaniz' Rule 204 testing.

- a. Response: **Dispute** – other testimony contradicts the Division's statement. The Division's statement also constitutes impermissible argument. *See* Post-Hearing Order ¶ 5(c).
- b. Counterstatement: Penson's statement in the OCIE response that "the processes and procedures employed to close out positions that were in violation of Rule 204T were effective and performed as designed. [Penson's] current procedures as they relate to Rule 204 are effective and designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1" was accurate.
  - a. Support:
    - Stip. FOF 61

FOF 61	<b>Brian Gover believed that the following language that he authored was accurate both when drafted and as of the date that he testified at the final hearing:</b> "Penson feels that the processes and procedures employed to close out positions that were in violation of Rule 204T were effective and performed as designed. Our [presumably meaning Penson] current procedures as they relate to Rule 204 are effective and designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1." Tr. 2491:9-19, 2491:25-2492:4.
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- Gover Testimony

A	And that is the section where it says "Penson feels that the processes and proceedings and options" –
Q	Yes.
A	That looks like something I could have written.
Q	Okay. When you -- when you wrote that, you would have understood that was going to FINRA, right?
A	Yes.
Q	And when you wrote that, did you believe it was accurate?
A	Yes.
Q	And as you sit here today, is there any reason to think that it's not accurate?
A	No.
(Hearing - Day 1, 147:17 – 148:4 , Oct. 27, 2014)	

- Alaniz Testimony

Q I'll just represent to you that S+1 is settlement plus one, which is the same as T+4. Based on your remediation plans that you had done, **did you believe that by November 2010, the firm's programs were effective and reasonably designed to close out short sales in --**

A Yes.

(Hearing – Day 3, 828:23 – 829:4, Oct 29, 2014)

- Hasty Testimony

Q **Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover's statement that "Penson's processes and procedures were effective and performed as designed," do you believe that was truthful and accurate?**

A Yes.

Q Do you have any reason to believe that Mr. Gover's statement was inaccurate?

A No.

Q Misleading?

A No.

(Hearing – Day 7, 1738:25 – 1739:10, November 4, 2014)

Q Okay. And I believe Michael pulled back up the language from 101. That's the final response. Looking again at the language in the final response, "Penson believes that," do you believe that his -- Mr. Gover's statement that, "Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of Rule 204T were effective and performed as designed." **Do you believe that that was truthful and accurate?**

A Yes.

Q Do you have any reason to believe that Mr. Gover's statement was inaccurate or misleading?

A No.

(Hearing – Day 7, 1739:11-23, November 4, 2014)

Q **Do you have any reason to believe anything in this final response was inaccurate or misleading?**

A No.

Q If you did believe anything in that response that you signed was inaccurate or misleading, what would you have done?

A I would have said something most likely to Tom or would have -- or to the business unit or would have called a meeting and said we need to discuss it.

(Hearing – Day 7, 1739:24 – 1740:7, November 4, 2014)

177. Supervision is an important part of a compliance program.

- Response: *No dispute*.

178. Yancey was hired as CEO because PFSI was growing too large for founders Pendergraft and Son to continue to manage.

- a. Response: *Dispute* – accuracy of statement. The testimony the Division quotes discusses why PFSI hired a CEO. It does not address why PFSI hired Yancey.
- b. Counterstatement: Pendergraft testified that **Yancey was hired as CEO because he was a great leader; had a passion for excellence and integrity; and had industry experience and capabilities.**
- c. Support:
  - Pendergraft Testimony

Q: I guess, Mr. Pendergraft, I would just like to know, in your words, **why you thought Mr. Yancey would be a good person to fill that chief executive officer position with PFSI?**

A: PFSI was the company we started, that we started with, and we had -- that was the -- while all of our businesses were important to us, this was one very special. **We wanted someone who had a passion for excellence, who had a passion for people, had a passion for integrity. We clearly wanted someone who had industry experience and capabilities and the skill set. But we weren't hiring that as much as we were hiring someone we thought could be a great leader of the organization.**

**Q: You had seen those characteristics and skills in Mr. Yancey when you had worked together before?**

A: Yes

(Hearing-Day 6, 1483:11-1484:2, Nov. 3, 2014)

Q: And reflecting back on the attributes that you wanted for someone in that position, and what you thought Mr. Yancey brought to the table, how do you describe his performance over the five to seven years that he primarily worked for you?

A: Like, certainly like me, like all of us, Mr. Yancey is not perfect, but he met or exceeded all of my expectations for him in leading the Penson Financial Services organization, and I think, as I've already said, those were pretty high expectations that I had.

Q: Did he bring the leadership skills that you were looking for?

A: Yes. Q: Is there a saying at Penson, Do what is right first and then make money second?

A: I think the way the phrase went was, It's more importance to do what's right than it is to make money.

Q: And did Mr. Yancey embrace that culture, to your knowledge?

A: Absolutely.

(Hearing-Day 6, 1486:25-1487:20, Nov. 3, 2014)

179. Yancey was the CEO of PFSI and was a registered person.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 2 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 2 as set forth below.
- c. Support:
  - Stip. FOF 2

FOF 2.	Yancey, 58, of Colleyville, Texas, was the President/CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker/dealer. Yancey holds Series 7, 24, 55, and 63 licenses.
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(See Order on Stipulations)

180. Delaney was a registered person associated with PFSI.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 102 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 102 as set forth below.
- c. Support:
  - Stip. FOF 102

FOF 102.	During the relevant time period, Michael Johnson and <b>Tom Delaney were registered representatives associated with PFSI.</b>
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(See Order on Stipulations)

181. Yancey had supervisory responsibility for Delaney.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 112 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 112 as set forth below.
- c. Support:
  - Stip. FOF 112

FOF 112.	Yancey had supervisory responsibility for Delaney.
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(See Order on Stipulations)

182. Yancey received and reviewed the Rule 204 Test results in December 2009.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Yancey **testified that he believed he** received and reviewed the Rule 204 test results in December 2009.
- c. Support:
  - Yancey Testimony

<p>Q And you saw a document, either this document or a document like this, while you were CEO of Penson Financial Services; is that right?</p> <p>A I did.</p> <p>Q Do you recall if you saw it in connection with those quarterly meetings we were just discussing?</p> <p>A I believe that I did.</p> <p>Q Okay. And is it fair to say that if you were given the 3012 test results, it's a document you would have reviewed?</p> <p>A Just a point of clarification.</p> <p>Q Yes.</p> <p>A <b>I believe that I received it</b> in December of 2009.</p> <p>Q You believe --</p> <p>A Is that helpful?</p> <p>Q You believe you received it in December of 2009?</p> <p>A I do.</p> <p>Q All right.</p> <p>A I saw it, I should say.</p> <p>Q Okay. And would you have reviewed it when you received it?</p> <p>A Yes, I would have reviewed it with the people that presented it to me.</p> <p>Q And who do you recall presented it to you?</p> <p>A Mr. Delaney and Mr. Alaniz.</p> <p>(Hearing- Day 3, 897:7-898:8, Oct. 29, 2014)</p>
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183. Yancey met with the Compliance department quarterly to discuss its Rule 3012 testing, which was part of the process of preparing Yancey to sign and certify Penson's Annual Certification of Compliance, also referred to as the CEO certification.

- a. Response: **No dispute**.

184. Issues would be raised at these quarterly meetings only if they were significant enough to warrant Yancey's attention.

- a. Response: **Dispute** – accuracy of statement; unclear as stated.



- b. Counterstatement: Yancey testified that in quarterly 3012 meetings he was advised of significant issues and he relied on others to identify things that might have warranted his involvement.

- c. Support:

- Yancey Testimony

Q All right. And at these quarterly meetings, you would be advised by people in your reporting chain if there were issues that were significant enough to be raised to your level; is that right?

A I think that's right.

Q And Mr. Yancey, **you relied on people to identify things that might have warranted your intervention or being involved; is that right?**

A Yes, sir.

(Hearing- Day 3, 891:12-891:20, Oct. 29, 2014)

185. On January 28, 2010, Delaney and Alaniz had a quarterly meeting with Yancey. In that meeting, the Rule 204 Test was **one of only two items** discussed with Yancey. Delaney and Alaniz explained the results of the Rule 204 Test and pointed out that 112 out of 113 items tested failed.

- a. Response: **Dispute** – contrary evidence. The Division’s statement is inconsistent with the supporting evidence (Ex. 134).

- b. Counterstatement: On January 28, 2010, Delaney and Alaniz had a quarterly meeting with Yancey. **They informed Yancey that the “Compliance department ha[d] tested, among other areas, SEC Rule 204 and the Transmittal of Funds.” Alaniz testified that** he pointed out that 112 out of 113 items in the Rule 204 test failed.

- c. Support:

- Exhibit 134

**From:** Eric Alaniz [REDACTED]  
**Sent:** Thursday, January 28, 2010 12:56 PM  
**To:** Bill Yancey  
**Cc:** Tom Delaney; Eric Alaniz  
**Subject:** 2009-2010 Quarterly Annual Certification Meeting

**Importance:** High

Bill,

Again, I'd like to thank you for the time you spent with Tom and me today reviewing our departments quarterly progress on the Annual 3012 Testing. Just as a quick recap of our meeting I have highlighted some areas discussed today.

Currently the Compliance department has tested, among other areas, SEC Rule 204 and the Transmittal of Funds. These two areas are now the focus of prompt remediation. The Compliance department will continue to review practices in areas of high regulatory concern and continually update our "Risk Based" testing approach including but not limited to areas identified during last years certification process, areas highlighted during regulatory examinations as well as those areas regulators have indicated will be areas of focus as we proceed throughout the year.

- Alaniz Testimony

Q Okay. And going back to Exhibit 70, the testing results that are there, did you ever report those findings to Mr. Yancey?

A Yes.

Q And explain that. When did that happen?

A I can't recall the exact date. I know we tried to see him every quarter to review the testing for that time period, and I believe that must have been sometime in January.

Q Okay. And what did you discuss with Mr. Yancey at that time?

A We discussed a **few** items. One item was Reg SHO.

Q And did you explain the results of that testing?

A Yes.

Q Did you explain to him that there was a 99 percent failure rate?

A I'm not sure if we used that exact language, but we did point out that, out of 113, 112 did fail.

(Hearing- Day 3, 709:22-710:16, Oct. 29, 2014)

- Yancey Testimony

Let's look at -- at January of 2010, Mr. Alaniz says, "Just as a quick recap of our meeting, I've highlighted some areas discussed today. Currently the Compliance department has tested, **among other areas**, SEC Rule 204 and the transmittal of funds."

That's what Mr. Alaniz says to you, correct?

A It is.

Q And as you sit here today, do you recall anything else discussed in the January 2010 meeting other than Rule 204 and transmittal of funds?

A You know, **I don't have a recollection** of anything else.

(Hearing- Day 3, 895:6-895:17, Oct. 29, 2014)

186. The Rule 204 Test was discussed in the March 31, 2010 quarterly 3012 CEO certification meeting, which was held on the same day that Yancey signed the 2010 Annual CEO Certification. At the meeting, the December 2009 Rule 204 testing was **one of ten items** discussed.

- a. Response: **Dispute**. The Division's statement is redundant of Stip. FOF 113 previously stipulated to by all parties. There is no basis for a separate finding of fact. Alternatively, the statement does not accurately reflect the testimony.
- b. Counterstatement: Stip. FOF 113 as set forth below.

Alternatively, the statement should read: The Rule 204 test was discussed in the March 31, 2010 quarterly 3012 CEO certification meeting, which was held on the same day that Yancey signed the 2010 Annual CEO Certification. At the meeting, **approximately ten** 3012 testing items, including the Rule 204 test, was discussed.

- c. Support:

- Stip. FOF 113

FOF 113. The Rule 204 December 2009 Audit was discussed in the March 31, 2010 quarterly 3012 CEO certification meeting, which was held on the same day that Yancey signed the 2010 Annual CEO Certification.

(See Order on Stipulations)

- Alaniz Testimony

Q At the March 31st, 2010 meeting, did you discuss the processes that you had tested in the 31 -- or the 3012 Rule 204 testing?

A **We typically start off with 3012 testing.** Tom Delaney usually spearheads that. From there, we choose the topic of -- **I believe we might have chosen 10 items.** And then from there, we would go down, indicating what we had found. If they needed more information, I did have booklets, kind of like this (indicating) here, with all the information and the details if they wanted to review it.

Q Okay. **And was your 3012 204 testing, was that one of the 10 items that was discussed?**

A **Yes.**

(Hearing- Day 3, 714:21-715:9, Oct. 29, 2014)

187. At the March 31, 2010 meeting Alaniz did not tell Delaney or Yancey that the Stock Loan remediation steps would solve the Rule 204 problem.

- a. Response: *Dispute* – contrary testimony and evidence.
- b. Counterstatement: At the March 31, 2010 meeting Yancey was assured that all remediation steps were being followed to solve the Rule 204 problem.
- c. Support:
  - Stip. FOF 77

FOF. 77	Following meetings in January and March 2010, Mr. Yancey was told that the 204 testing results were the subject of <i>prompt remediation</i> and that the relevant departments were cooperating.
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- Stip. FOF 17 (“Upon learning of Rule 204 deficiencies in Buy-Ins through the December 2009 audit, Delaney oversaw *extensive remediation efforts*”),
- Stip. FOF 64

FOF. 64.	Penson undertook <i>substantial remediation efforts</i> following the November and December 2009 testing by Eric Alaniz of Penson's Rule 204 compliance, and these remediation efforts began at least as early as January 2010.
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- Alaniz Testimony

<p>Q Okay. As you -- as you read this, did you believe that these remediation steps, if implemented, would resolve the problems that your testing had discovered?</p> <p>A Yes.</p> <p>Q And did you have any reason to believe when you got this from Stock Loan that it wouldn't be implemented?</p> <p>A No.</p>
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(Hearing- Day 3, 772:8-15, Oct. 29, 2014)

- Exs. 134, 669 (January 28, 2010 email from Alaniz to Yancey stating SEC Rule 204 is now the focus of “prompt remediation”).
- Alaniz Testimony

<p>Q: What did you say?</p> <p>A: <b>I had told him that I didn't believe that was necessary. All indications from the security lending department and the buy-ins department was that they were cooperative in remediating those issues.</b></p>
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(Hearing-Day 3, 763: 5-7, Oct. 29, 2014)

**A: From the discussions that John Kenny had with Brian [Gover], they had – they had discussed remediation issues or remediation communication items to conform with the rule and I had no issue with that.**

Q: You had no issue with the remediation they discussed?

A: No. . . .

**Q: Okay. So whether they were – had been in substantial compliance when you did your testing, you understood they were on the road to substantial compliance when you were in this [March] meeting; is that right?**

**A: Yes.**

(Hearing-Day 3, 795:7-21, Oct. 29, 2014)

Q: And the discussion on the Rule 204 test was an update on the remediation measures; is that right?

A: The discussion of 204 was more with the issues that were found and also of the remediation that the – the subject matter experts were implementing. . .

**Q: And you previously testified that, in fact, Mr. Gover and Mr. Kenny engaged in a 15-minute or so discussion of the remediation efforts; is that right?**

**A: Yes.**

Q: Do you remember specifically what they said?

A: He asked Brian Gover what the issue was and Brian Gover responded. At that point, there was a conversation between them. At that point, he asked him what he was doing to rectify the situation, and he spoke about a report that they were trying to highlight to relieve the issue.

(Hearing-Day 3, 851:20 – 852:16, Oct. 29, 2014)

188. Yancey and Delaney met to discuss and review the Annual Report.

a. Response: *No dispute.*

189. As part of the process of signing and certifying the 2010 Annual CEO Certification, Yancey carefully reviewed the Annual Report, which he considered an important document.

a. Response: *No dispute.*

190. Yancey personally signed the Annual CEO Certification; it was an important document.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: Yancey personally signed the Annual CEO Certification; **he testified that he took that certification seriously.**

c. Support:

- Stip. FOF 114

- Yancey Testimony

So this is the 2010 CEO certification; is that right?

A Yes, sir.

Q And that is for 2009 to 2010, that's the cycle, correct?

A Yes, sir.

Q All right. And again, if we look at the bottom, that is your personal signature, correct?

A It is.

Q You -- you put pen to paper and signed that document?

A Yes, sir.

Q **Now, you took that certification seriously, didn't you?**

A **Yes, sir.**

(Hearing- Day 3, 884:21-885:10, Oct. 29, 2014)

191. Yancey was aware that the CEO Certification and Summary Report were sent to regulators.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 115 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 115 as set forth below.
- c. Support:
  - Stip. FOF 115

FOF 115. Yancey was aware that the CEO Certification and Summary Report were sent to regulators.

(See Order on Stipulations)

192. Yancey does not know why the results of the Rule 204 Test were not included in the Rule 3012 Summary Report.

- a. Response: **Dispute** – accuracy of statement. As stated, the Division's statement indicates that the results of the Rule 204 testing were entirely excluded from the Rule 3012 Summary Report. The statement is inconsistent with the scope of the supporting testimony, which addresses only "significant compliance problems."
- b. Counterstatement: Yancey **testified that he** does not know why the results of the Rule 204 test were **not listed among the significant compliance problems** in the Rule 3012 Summary Report.
- c. Support:
  - Yancey Testimony

Q Okay. Now, Mr. Yancey, **you don't know why the results of the SEC Rule 204 testing are not listed among the significant compliance problems** in Exhibit 135, do you?

A No, sir.

Q You do not know?

A I do not know.

(Hearing- Day 4, 938:22-939:3, Oct. 30, 2014)

- *See also* Delaney Testimony (confirming it the December 2009 audit results were not *explicitly* listed, but the testing results were inclusive in the material contained within the report)

Q And the December audit, which we've seen was -- you believe was the focus of prompt remediation, **was not explicitly listed** as an item in that Summary Report; do you agree with that?

A I do.

Q Why was it not specifically identified?

A The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and **it was inclusive in the material that was there with the report.**

(Hearing-Day 5, 1361:25-1362:10, Oct. 31, 2014)

193. Yancey did not have any discussion with anyone, including Delaney, about omitting the Rule 204 testing from the Rule 3012 Summary Report.

- a. Response: **Dispute** – unclear as stated. As stated, the Division’s statement implies that the Rule 204 testing was entirely excluded from the Rule 3012 Summary Report. Instead, the supporting testimony is limited to whether Yancey had discussions about omitting “discussion” of the Rule 204 testing from the annual report.
- b. Counterstatement: **Yancey testified that** he did not discuss **omitting explicit discussion** of the Rule 204 testing results from the 3012 Summary Report.
- c. Support:
  - Yancey Testimony

Q And, Mr. Yancey, **you did not have any discussions with Tom Delaney about omitting discussion of the Rule 204 testing from the annual report, did you?**

A No, sir.

Q And you did not have any discussions with anyone else about omitting **discussions of the Rule 204 audit results from the report, did you?**

A I did not.

(Hearing- Day 4, 939:4-939:16, Oct. 30, 2014)

Q Did you have any discussion with Mr. Delaney or anyone else about not including the 204 testing on this Summary Report?

A No.

(Hearing- Day 7, 1888:1-1888:4, Nov. 4, 2014)

- *See also* Delaney Testimony (December 2009 audit results were not *explicitly* listed, but the testing results were inclusive in the material contained within the report)

Q And the December audit, which we've seen was -- you believe was the focus of prompt remediation, **was not explicitly listed** as an item in that Summary Report; do you agree with that?

A I do.

Q Why was it not specifically identified?

A The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and **it was inclusive in the material that was there with the report.**

(Hearing-Day 5, 1361:25-1362:10, Oct. 31, 2014)

194. **Yancey knew that it was important to be as accurate as possible** in communications with regulators, and that honesty in communications with regulators are the very fabric of a compliance program.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey testified that he believes** that the fabric of the Compliance program “revolves around honesty and integrity,” including honesty and integrity in communicating with regulators.
- c. Support:
  - Yancey Testimony

Q If Tom Delaney were misleading regulators, that's something that would have been important to you?

A Yes, sir.

Q And why is that? Why would that be important to you?

A **I think the very fabric of the Compliance program revolves around honesty and integrity.**

Q **Including honesty and integrity in communicating with regulators?**

A Yes, sir.



(Hearing- Day 3, 880:20-881:4, Oct. 29, 2014)

195. If Delaney were **misleading regulators in communications** with those regulators, that is something that would have been important to Yancey.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey agreed that** if Delaney were **misleading regulators**, that is something that would have been important to Yancey.
- c. Support:
  - Yancey Testimony

Q If Mr. Delaney were misleading regulators, that's something you would want to know about?

A Yes, sir.

Q If Tom Delaney were misleading regulators, that's something that would have been important to you?

A Yes, sir.

Q And why is that? Why would that be important to you?

A I think the very fabric of the Compliance program revolves around honesty and integrity.

Q Including honesty and integrity in communicating with regulators?

A Yes, sir.

(Hearing- Day 3, 880:17-881:4, Oct. 29, 2014)

196. If Yancey saw a red flag that suggested Delaney was not being honest with regulators, he had a duty to follow up on it.

- a. Response: **Dispute** – accuracy of statement. The Division's statement does not reflect the scope of the supporting testimony and calls for a legal conclusion.
- b. Counterstatement: **Yancey testified that to the extent he detected a red flag** that suggested Delaney was not being honest with regulators, **Yancey agreed** he had a duty to follow up on it.
- c. Support:
  - Yancey Testimony

Q And let me ask you: If you saw a red flag that suggested that Mr. Delaney wasn't being honest with regulators, can we agree that you would have had a duty to follow up on that?

A **To the extent I had detected a red flag**, I would have followed up on it.

Q That's fair, sir.

**So to be sure it's clear, if you had detected something that was a red flag, that you considered a red flag, we can agree that you would have a duty to follow up on it?**

A Yes, sir.

(Hearing- Day 3, 882:11-882:22, Oct. 29, 2014)

197. Yancey was the CEO of PFSI and was a registered person.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 2 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 2 as set forth below.
- c. Support:
  - Stip. FOF 2

FOF 2. Yancey, 58, of Colleyville, Texas, was the President/CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker/dealer. Yancey holds Series 7, 24, 55, and 63 licenses.

(See Order on Stipulations; Hearing-Day10, 2288:20-2289:2, Nov. 7, 2014)

198. Johnson is a registered representative associated with PFSI.

- a. Response: ***No dispute***, although the Division's statement is redundant of Stip. FOF 102 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 102 as set forth below.
- c. Support:
  - Stip. FOF 102

FOF 102. During the relevant time period, Michael Johnson and Tom Delaney were registered representatives associated with PFSI.

(See Order on Stipulations)

199. Stock loan, as well as the other functional groups within PFSI, reported up to Yancey.

- a. Response: ***Dispute*** – accuracy of statement. Testimony and evidence contravenes the Division's statement as written.
- b. Counterstatement: PFSI Stock Loan reported up to Mike Johnson, who was supervised by Phil Pendergraft.
- c. Support:

- Stip. FOF 55 (“Johnson oversaw securities lending activities at PFSI.”)
- Yancey’s Prop. FOF 9, 14, 101, and 102 and supporting evidence therein (evidence that Pendergraft supervised Johnson)
- *See, e.g., De La Sierra Testimony*

Q: Mr. DeLaSierra, given your personal observations and the documents we’ve discussed, in our experience with supervisors, **you would agree that Mr. Pendergraft was supervising Mr. Johnson?**

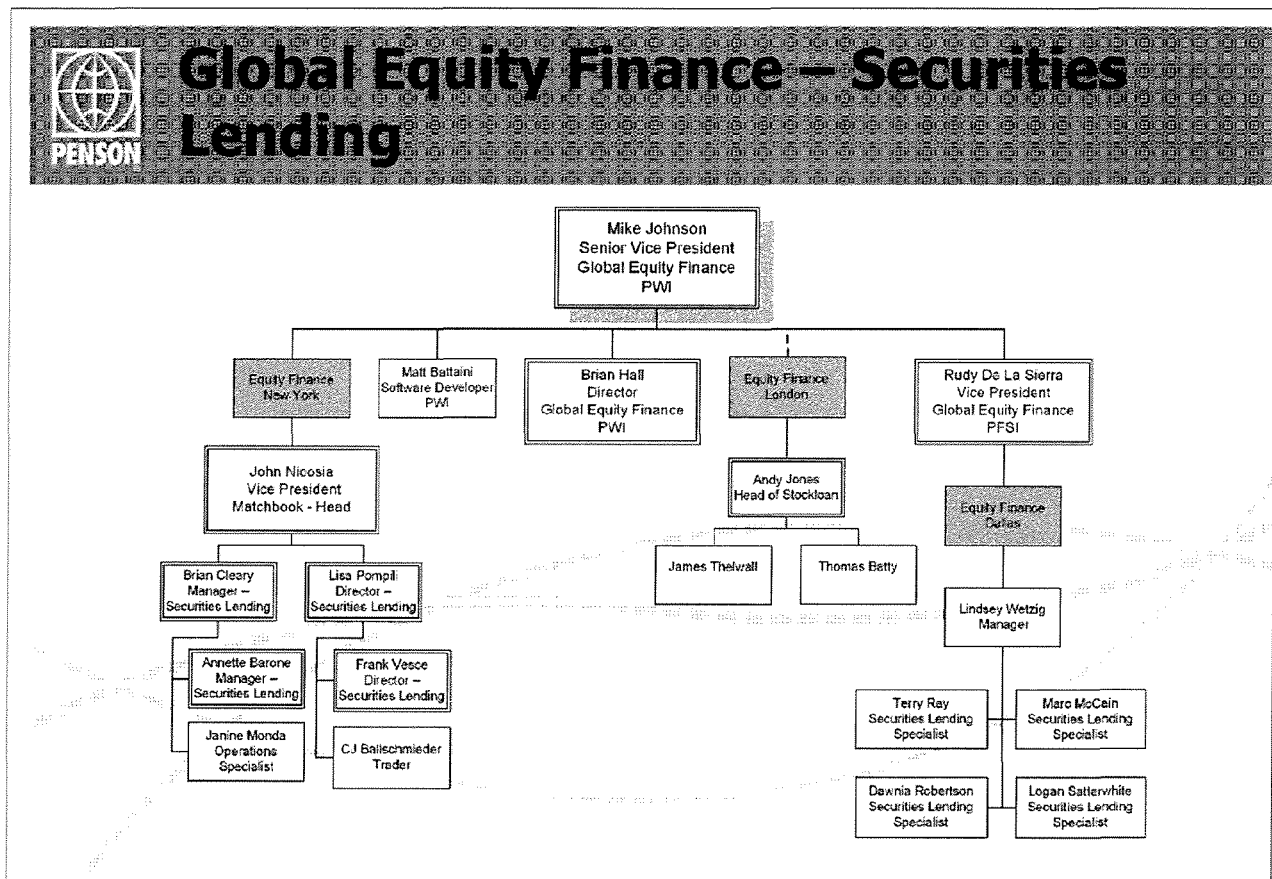
A: Yes.

Q: Okay. And, indeed, that supervision extended to PFSI activities?

A: Yes.

(Hearing-Day 1, 302:22-303:4, Oct. 27, 2014)

- *See, e.g., Ex. 571 (2009 Organizational Chart)*



200. PFSI's Stock Loan department lent shares owned by PFSI customers to earn borrow charges, used that stock as collateral for financing purposes, lent stock for financing purposes, and borrowed stock for PFSI's to cover PFSI customer's short sales.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Among other things**, PFSI's Stock Loan department lent shares owned by PFSI customers to earn borrow charges, used that stock as collateral for financing purposes, lent stock for financing purposes, and borrowed stock for PFSI's **customers** to cover PFSI customers' short sales.
- c. Support:
  - Gover Testimony

Q And what did they do? What did PFSI's Stock Lending department do?

A There's -- **there's a couple of functions of Stock Loan**. One is that they're maximizing the utility of the balance sheets. So if there are shares that -- goes back to the hypothecation agreement. So we have shares that somebody had a loan with Penson, and that loan is collateralized by the shares. Under the hypothecation agreement, Penson can lend the shares out, and for a couple functions. So one of the -- **one of the functions** of Stock Loan was if we had shares that we were -- they were -- the term is "access," access available to loan, that we would lend those shares out to parties who wanted to borrow them. And in exchange for that, you get borrow charges. \*\*\*

A **The other function** would be as a part of financing functions, clearing firms can finance the business in a couple ways. You can borrow money from banks and put up generally stock as collateral. You can also lend securities out to other parties. You can get cash for the lending of the stock, and that can also be used to finance the firm's operations.

Q Did they also engage in stock borrowing, the PFSI Stock Lending department?

A Yes. They would borrow stock.

Q And why -- why would they do that?

A I think in general if -- if Penson has a fail and we do not have the shares to make delivery, Stock Loan -- and so those would result from short sales. Stock Loan could recall the shares or borrow shares to make a delivery. So that's -- there's a couple reasons that you can borrow. The primary is because you -- you let somebody -- you gave approval. You gave a locate for a customer to sell short. And that customer sold short, and then you need to borrow -- borrow shares to cover the short. The other would be it's really a pure financing function. If you have a fail, so a fail that there's no obligation to buy-in, but it would be advantageous to be able to borrow the shares so that you can make delivery and get the cash. And it's -- it's -- the other piece is just pure really cash management, managing your -- your daily cash flows.

(Hearing- Day 1, 90:22-92:19, Oct. 27, 2014)

201. Stock Loan supported PFSI customers' short selling by providing "locates" on shares – affirmative determinations that the shares would be available – before the customer engaged in the short sale.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: Stock Loan supported PFSI customers' short selling by providing "locates" on shares – an affirmative determination that the shares are **currently available** – a **prerequisite** before the customer engaged in the short sale.
- c. Support:
  - De La Sierra Testimony

Q ... You said one of the things you did was short locates; is that right?

A Correct.

(Hearing- Day 1, 205:13-205:15, Oct. 27, 2014)

A On trade date, short sellers are required to get a locate before they place a short sale order, so --

Q Was it -- I'm sorry. What does it mean to get a locate?

A Locate, calling your brokerage firm, and they -- **they're required to get affirmative termination to make sure the shares are there to approve this short sale.** So when a customer comes in, it's a locate. We approve that locate for the customer. They then can do whatever they want. It's not a short sale until they place the short sale order. At that point, it's just a locate before they place a trade.

Q And you talked about placing a short sale. What is a short sale?

A A short sale is the opposite of a long sale. Short sellers will profit when the security goes down in price. Since they don't own the securities, they have to get a locate.

(Hearing- Day 1, 205:17-206:9, Oct. 27, 2014)

- Wetzig Testimony

Q We've heard a little bit about it, but I want to unpack those things. When you say they "did locates," what does it mean to do a locate?

A So for a broker to be able to short sell stock, he has to receive a locate on that security. So we will have to see some sort of inventory or feed from another broker-dealer in order to give them a locate.

Q And that's something that Penson Financial Services would give?

A Correct.

(Hearing- Day 2, 346:13-346:22, Oct. 28, 2014)

202. Stock Loan also supported PFSI customers' short selling by borrowing securities to satisfy the obligation to settle the short sale trade on T+3.

- a. Response: *No dispute.*

203. Stock Loan also lent securities from PFSI customers' margin accounts to its counterparties so **they** could meet their customers' delivery obligations.

- a. Response: **Dispute** – ambiguous and unclear as stated.
- b. Counterstatement: Stock Loan also lent securities from PFSI customers' margin accounts to its counterparties so **the counterparties** could meet their customers' delivery obligations.
- c. Support:
  - De La Sierra Testimony

Q ... You also said that you lent securities out of your box. Can you explain what that means?  
A So just as we're trying to borrow for our delivery obligations, our counterparties also have delivery obligations. They -- we would come in every morning and there's a list from whoever, you know, our counterparties are, the names that they are looking for for their delivery obligations. We would check our box and, you know, decide who to lend it to you, know based, on the best market terms we can get.

(Hearing- Day 1, 208:2-208:13, Oct. 27, 2014)

204. Providing locates, borrowing securities, and lending securities, were functions of PFSI's Stock Loan department rather than Pension Worldwide.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 116 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 116 as set forth below.
- c. Support:
  - Stip. FOF 116

FOF 116. Providing locates, borrowing securities, and lending securities, were functions of PFSI's Stock Loan Department rather than Pension Worldwide.

(See Order on Stipulations)

205. Stock Loan was a significant profit center for PFSI.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Stock Loan **made up approximately 10%** of PFSI's annual revenue.
- c. Support:

- McCain testimony

Q Okay. What was the **percentage of PFSI revenue that was made up of Stock Loan** or Stock Loan revenue?

A That's a hard question. My best recollection on that is that it was -- it varied from **7 to 10 percent**.

(Hearing- Day 9, 2164:19-2164:24, Nov. 6, 2014)

- Ex. 239 at p.15 ¶ 49

lending client shares are often a significant source of their business revenues. The

Penson Stock Loan Department generated average monthly revenues of \$1.94 million,

or approximately \$23.3 million per year, during the period October 2008 to April 2012.<sup>3</sup>

- Pendergraft Testimony

Q: What percentage, if you know, and again, feel free to just give me a ballpark, of the total **revenue of PWI was generated from all of the stock lending** done by any entity that was doing stock lending?

A: I don't know.

Q: If I said less than 10 percent, would you think that sounds about right or no basis to say?

A: Let me make sure I understand the question. **Less than 10 percent -- that stock lending revenue was less than 10 percent of Penson Worldwide's revenue; is that the question?**

Q: Yes, sir.

A: **I don't know. That wouldn't surprise me, but I don't know.**

(Hearing-Day 6, 1491:15-1492:3, Nov. 3, 2014)

206. Stock Loan generated revenue by lending out securities to counterparties, who generally paid a “rebate” to borrow the securities, and by borrowing securities to assist with customer short selling and charging a mark-up to customers for the cost of the borrow.

- a. Response: **No dispute.**

207. Stock Loan also financed PFSI. Financing through Stock Loan was advantageous compared to financing through bank loans because PFSI got more value for the stock pledged as collateral, and because PFSI paid a lower interest rate on the loan.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Stock Loan was one department that assisted in financing PFSI.** Financing through Stock Loan was advantageous compared to financing

through bank loans because PFSI got more value for the stock pledged as collateral, and because PFSI paid a lower interest rate on the loan.

c. Support:

- De La Sierra Testimony

Q And what did they do? What did PFSI's Stock Lending department do?

...

A The other function would be as a part of financing functions, **clearing firms can finance the business in a couple ways.** You can borrow money from banks and put up generally stock as collateral. You can also lend securities out to other parties. You can get cash for the lending of the stock, and that can also be used to finance the firm's operations.

(Hearing-Day1, 90:22-91:21, Oct. 27, 2014)

Q You also said, I believe, in your list of the things that Stock Lending did for Penson Financial Services something about financing the firm; do you recall that?

A Yes.

(Hearing- Day 1, 209:23-210:2, Oct. 27, 2014)

Q So if I understand, I think I heard you talk about two advantages of using stock lending finance instead of a bank.

The first is you get more value for your collateral, 100 percent instead of 80 percent; is that a fair summary?

A That's correct.

Q And the second was that it's also cheaper to do financing through stock lending than a bank, correct?

A Yes, that's correct.

(Hearing- Day 1, 211:8-211:17, Oct. 27, 2014)

- Yancey Testimony

Q Okay. Stock Lending is used, in part, for financing purposes; is that right?

A Can be.

Q It can be. And how does Stock Lending help finance a firm?

A Sure. When the customers open a margin account and they sign a hypothecation agreement and they take a loan out against their collateral, the securities are eligible to be lent or used for financing their margin debits.

Q And at Penson Financial Services, between 2008 and 2011, did you all use Stock Lending to help finance the firm?

A Yes.

(Hearing- Day 4, 943:15-944:3, Oct. 30, 2014)



Q Tell me about firm financing and how the Stock Loan and financing worked together.

A Okay. So if a customer deposited stock in a margin account and signed a margin agreement or a hypothecation agreement and then ultimately borrowed money from that account, the firm could pledge the collateral to a bank sufficient to not have to tie up their money for the purpose of the loan to the -- to the investor, or to the extent that there was an excess of any security, could use that excess in Stock Loan for a firm -- what they call firm financing.

Q What was firm financing? How did it get used in firm financing?

A Firm financing is really -- in a pledge relation program at a bank, where you pledge up the securities, the normal haircut is 20 percent, or that's an industry term, haircut. That means the loan to value is approximately 80 percent. In the Stock Loan world, the loan to value could be 100 percent.

So in order to maximize the balance sheet, you often use Stock Loan for the purpose of financing.

(Hearing- Day 7, 1831:7-1832:2, Nov. 4, 2014)

- McCain Testimony

Q I think it might be helpful, Mr. McCain, if you spent a moment explaining how, first, financing fits into stock lending, since you have some understanding.

A The component of stock lending that I understand is -- it's related to the financing of the firm -- is a broker-dealer has basically two ways to finance the business. One is through a bank loan, where they can go to the bank, pledge up collateral and -- to the bank, and the bank will advance approximately 80 percent of the market value. The other way is that -- and really a more efficient way is for Stock Loan to lend out securities to other counterparties, and they get an advance rate of about 98 percent, and the interest rate is much, much lower than what a bank would charge.

(Hearing- Day 9, 2165:12-2166:2, Nov. 6, 2014)

208. Stock Loan's firm financing function was important to PFSI.

a. Response: *No dispute.*

209. Stock Loan was a necessary and integral part of PFSI's business model.

a. Response: *No dispute.*

210. PFSI could not have existed without Stock Loan.

a. Response: *Dispute* -- accuracy of statement.

b. Counterstatement: **De La Sierra testified that, in his opinion, PFSI could not have existed without Stock Loan.**

c. Support:

- De La Sierra Testimony

Q Could a broker-dealer exist without a stock lending function, if you know?

A Not a firm like Penson, no.

(Hearing- Day 1, 213:6-213:8, Oct. 27, 2014)

211. Because Stock Loan was a **core function of PFSI it is not surprising that** the supervisory matrices show Johnson reporting to Yancey, the CEO.

- a. Response: *Dispute* – accuracy of statement. Also, Division's statement consists of impermissible argument and should be stricken. *See* Post-Hearing Order.
- b. Counterstatement: Delaney stated in his third investigative testimony that he would expect a core function of the broker-dealer would report in through the CEO.
- c. Support:

- Delaney Testimony

Q Okay. And can you look at Exhibit 201. And we looked at Exhibit 201 before as well. If you look at the fourth page of the attached letter, if you look at Number 11, in response to FINRA's request that Penson provide a description of Penson's supervisory chain identifying each supervisor's direct reports, as well as the individual to which each supervisor reports, Ms. Miller attaches a Supervisory Matrix; isn't that right?

A Yes, that's right.

Q And if you look at the last page of that document -- oops, it's not the last page of the document. I guess it's Page 19, maybe, the Supervisory Matrix that's attached to that document. Do you see the Supervisory Matrix?

A Yes, ma'am.

Q And that shows a grid with Bill Yancey at the head of it, Mike Johnson under Bill Yancey, and it says that Bill Yancey is Mike Johnson's regulatory supervisor and pi org chart supervisor; is that right?

A That's what it says, yes, ma'am.

Q Okay. **And when you were asked in your third testimony** with this counsel representing you whether you were surprised that Mike Johnson was under Bill Yancey on a Supervisory Matrix, you said, "It may not surprise me if it's there because I would think what those Supervisory Matrices were trying to show was that this is a broker-dealer function and, therefore, the CEO is responsible for all issues of the broker-dealer."

Question: "You're thinking of the business units to report to the CEO?"

Answer: "Yes, sir. So while functionally that may -- from an HR standpoint, there might not have been a -- there might not have been a reporting relationship from an HR standpoint, **it certainly would have been my expectation from a compliance standpoint that a core function of the broker-dealer would report into from a supervisory standpoint. The**

**supervisory in a broker-dealer context would have reported in through the CEO.** So what we were really trying to show in supervisory procedures wasn't necessarily -- wasn't necessarily reporting relationships as far as HR relationships go, more so in terms of from a pure supervision of the broker-dealer standpoint, how would that have flown or how would that -- how would that -- the flow of that look."

**Do you remember giving that testimony?**

A I -- I don't remember giving that testimony. I remember -- I remember giving a third testimony, and **I'm not disputing that those were the words that I said; I just don't remember giving that.**

Q You don't doubt that you gave that testimony?

A No.

(Hearing- Day 5, 1391:11-1393:12, Oct. 31, 2014)

212. Johnson was initially hired to head the Stock Loan department at PFSI.

- a. Response: **Dispute** – accuracy of statement. The Division's statement is not supported by the cited testimony nor any evidence in the current record.
- b. Counterstatement: Johnson's first position at Penson was Vice President of Securities Lending.
- c. Support:
  - Johnson Testimony

Mr. Johnson, at any point in your career, were you employed by Penson Financial Services?

A Yes.

Q What was your title and job?

A I think for Penson Financial Services, it was Vice President of Securities Lending.

(Hearing- Day 2, 513:17-513:22, Oct. 28, 2014)

213. Johnson was a very involved supervisor of PFSI's Stock Loan department throughout the time period relevant to this case. He was the "big boss"; the leader of PFSI's Stock Loan group.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **De La Sierra testified that Johnson was a very involved supervisor of PFSI's Stock Loan department and that he was the leader of PFSI's Stock Loan group. Wetzig testified that he was the "big boss" of PFSI's Stock Loan department.**
- c. Support:
  - De La Sierra Testimony

Q ... Who was Mike Johnson?  
A Mike Johnson was the Senior Vice President of Securities Lending. He was my boss.  
Q He was your boss?  
A Yes.  
Q How would you describe Mr. Johnson as a boss, as a supervisor? Was he involved, detached?  
A He was very involved.

(Hearing- Day 1, 217:4-12, Oct. 27, 2014)

Q Now, you were the Vice President; am I getting your title right, the Vice President of PFSI Stock Lending?  
A Yes.  
Q And how many direct reports did you have?  
A Just Lindsey.  
Q Okay. And how many people were below Lindsey?  
A Lindsey, four.  
Q Okay. Did you feel that they kind of all rolled up to you, that you were the leader of that group?  
A No. I felt like that Mike was.  
Q Mike was the leader of that group?  
A Right.

(Hearing- Day 1, 309:11-309:23, Oct. 27, 2014)

- Wetzig Testimony

Q Okay. Now, you mentioned -- you mentioned Mr. Johnson, Mike Johnson. I want to talk a little bit about Mr. Johnson. Could you describe his involvement in Penson Financial Services, the broker-dealers Stock Lending operations.  
A So Mike was obviously the big boss. He was, you know, the guy in the corner office, and he was hired from LoanNet.

(Hearing- Day 2, 350:17-350:24, Oct. 28, 2014)

Q I think the question was generally about Mr. Johnson and his involvement in Penson Financial Services Stock Lending group.  
A So, yes, Mike knew the -- the stock loan business well, and he was involved in, you know, everything that we did. If we had any questions or issues, we would -- we felt free to come talk to him.

(Hearing- Day 2, 351:15-351:21, Oct. 28, 2014)

Q And I know you mentioned Mr. Johnson's knowledge of Stock Lending. Talk to us about his -- his involvement in the Penson Financial Services Stock Lending group. Was he hands on, hands off? How would you describe it?

A I would -- I would say that he was hands on.

(Hearing- Day 2, 352:8-352:13, Oct. 28, 2014)

Q Was he a hands-on or a hands-off manager of the PFSI Stock Loan department?

A He -- he was hands-on.

(Hearing- Day 2, 415:24-416:1, Oct. 28, 2014)

214. Johnson was personally involved in borrowing securities for PFSI customers, locating shares for PFSI customers, and in financing activities for PFSI.

a. Response: **Dispute** – accuracy of statement.

b. Counterstatement: **De La Sierra testified that Johnson was involved in borrowing securities for PFSI customers, locating shares for PFSI customers, and in financing activities for PFSI.**

c. Support:

- De La Sierra Testimony

Q How would you describe Mr. Johnson as a boss, as a supervisor? Was he involved, detached?

A He was very involved.

Q What makes you say that?

A Well, he -- he was on the phones. He had accounts he dealt with that he would -- you know, first thing in the morning, 6:00 a.m., **whenever we were up, he was loaning securities. He would get involved if we needed to borrow, if we needed to finance.**

Q The accounts that Mr. Johnson dealt with, were those accounts at Penson Financial Services, the broker-dealer?

A Yes.

Q The borrows Mr. Johnson dealt with, were those borrows for Penson Financial Services customers?

A Yes, they were.

Q **And I think you also mentioned doing locates.** Or did I mishear you? I'm sorry.

A I didn't mention it, but he would get involved in locates. If there was something really hard or none of us could find them, he would also get involved.

Q And was that also something, again, for Penson Financial Services, the broker-dealer?

A Yes.

Q Okay. At what point in time did Mr. Johnson become your direct boss? A When he started in, I think, 2004 or -5.

Q And was he always your supervisor at Penson Financial Services Stock Lending?

A He was.

(Hearing- Day 1, 217:4-218:14, Oct. 27, 2014)

- Wetzig Testimony

A ...[Johnson] liked loaning securities. **So every morning he would come in, participate in the -- the lending of the securities with his relationships.**

Q And when you say "the lending of securities," are we talking about Penson Financial Services's securities?

A Yes.

(Hearing- Day 2, 352:14-352:20, Oct. 28, 2014)

215. Johnson was involved in substantive issues regarding PFSI Stock Loan, including issues related to Rule 204.

a. Response: *No dispute.*

216. Sometime prior to the implementation of Rule 204T, Johnson became the PWI Senior Vice President for Global Stock Lending, responsible for all of Penson's worldwide stock lending operations.

a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 117 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.

b. Counterstatement: Stip. FOF 117 as set forth below.

c. Support:

- Stip. FOF 117

FOF 117. Sometime prior to the implementation of Rule 204T, Johnson became the PWI Senior Vice President for Global Stock Lending, responsible for all of Penson's worldwide stock lending operations.

(See Order on Stipulations)

217. Johnson's interactions with the PFSI Stock Loan department did not significantly change after his promotion. He remained a highly-involved, hands-on manager over PFSI Stock Loan.

a. Response: *Dispute* – accuracy of statement. Statement not supported by cited testimony.

b. Counterstatement: After Johnson's employment changed to Penson Worldwide, Johnson remained involved in borrowing and lending securities for PFSI.

c. Support:

- De La Sierra Testimony

Q Do you know whether there came a time where Mr. Johnson was -- his employment changed from Penson Financial Services to Penson Worldwide? A Yes, it did.

...

Q Describe for us how his interaction with you changed once he changed employment at Penson Worldwide?

A I saw little change.

Q What do you mean by that?

A **He was involved with PFSI as he was before.**

Q **And what were the ways that you saw Mr. Johnson remain engaged with PFSI Stock Lending?**

A **He was still lending securities, borrowing.** He still had his few contacts that he was dealing with. He still maintained a relationship with them where he was the primary contact for them. It didn't change.

Q Before Mr. Johnson was moved into a PWI employee, how often did you and Mr. Johnson interact?

A Daily.

Q How about afterwards; how often did you and Mr. Johnson interact?

A Also daily.

(Hearing- Day 1, 218:15-219:14, Oct. 27, 2014)

- Wetzig Testimony

Q All right. And in practical terms, **describe how his involvement with the Penson Financial Services Stock Lending group changed when his title changed.**

A I don't think his involvement changed very much. I mainly think it was a title upgrade and he -- whether he was a Vice President or Senior Vice President, **he ran all of the Stock Loan; so our Canadian office, our London office, our Australian office and our Dallas office.**

(Hearing- Day 2, 353:5-353:13, Oct. 28, 2014)

Q All right. I think when you started talking about Mr. Johnson, you described him as the "big boss." Was that true both before and after his promotion?

A Correct.

(Hearing- Day 2, 354:5-354:8, Oct. 28, 2014)

- Yancey Testimony

Q Tell me a little bit now about the Stock Loan department at PFSI and who -- let's start with who headed Global Stock Lending?

A Mike Johnson.

Q And was he responsible for stock lending in the U.S. as well as global?

A Yes, ma'am.

Q Who reported to him?

A Rudy De La Sierra, Brian Hall, Lindsey Wetzig, Mark McCain, Dawnia Robertson, Logan Satterwhite. I think it's Dawnia Robertson.

(Hearing- Day 7, 1830:14-1830:24, Nov. 4, 2014)

218. After his promotion, Johnson remained associated with PFSI.

a. Response: *No dispute.*

219. After his promotion, Johnson continued to engage in stock lending activity for PFSI.

a. Response: *No dispute.*

220. Pendergraft considered Johnson one of the best technicians on Wall Street.

a. Response: *No dispute.*

- Johnson Testimony

Q Okay. Do you ever recall Mr. Pendergraft saying things like he thought you were one of the best technicians on Wall Street?

A Yes.

(Hearing- Day 2, 529:15-529:18, Oct. 28, 2014)

221. As President and CEO of PFSI, a broker-dealer, supervision rested with Yancey unless and until he reasonably delegated supervisory responsibility to another qualified individual.

a. Response: *Dispute.* The Division's statement calls for a legal conclusion.

b. Counterstatement: *See Yancey Prop. COL 9.*

i. Alternatively, the statement should be modified as follows:

**Yancey and Poppalardo both agreed** that supervision rests with the CEO of a broker-dealer unless and until the CEO delegates supervisory responsibility by assigning supervisory responsibility to experienced, qualified individuals of the firm.

c. Support:

- Yancey Testimony

Q Now, Mr. Yancey, from 2008 to 2011, you were the President and CEO of Penson Financial Services; is that correct?

A Yes, sir.

Q And Penson Financial Services was a broker-dealer, correct?



A Yes, sir.

**Q Would you agree with me that at a broker-dealer like Penson Financial Services, supervision rests with the CEO unless and until he reasonably delegates supervisory responsible -- responsibility -- excuse me -- by assigning experienced, qualified individuals to supervise the business activities of the firm?**

A Yes, sir.

(Hearing- Day 3, 877:23-878:11, Oct. 29, 2014)

- Ex. 828 (Poppalardo Expert Report) at 6

In a financial services firm, supervision rests, initially, with the CEO, unless and until he reasonably delegates supervisory responsibility by assigning experienced, qualified individuals to supervise the business activities of the firm.<sup>10</sup> The roles and responsibilities of a CEO in a

222. As President and CEO of PFSI, Yancey was responsible for compliance with the securities laws and other requirements imposed on the firm unless and until he reasonably delegated those functions to another qualified individual.

- a. Response: *Dispute*. The Division's statement calls for a legal conclusion.
- b. Counterstatement: See Yancey Prop. COL 9. See also response to Div. Prop. FOF 221.
  - i. Alternatively, the statement should be modified as follows:

**Yancey agreed** that the President of a broker-dealer is responsible for compliance requirements imposed on his firm unless and until he reasonably delegates those functions to another person.
- c. Support:
  - Yancey Testimony

**Q And I think we can also agree that the President of a broker-dealer is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates functions to another person in the firm and neither knows nor has reason to know that such a person's performance is deficient; would you agree with that statement?**

A I would, sir.

(Hearing- Day 3, 878:12-878:19, Oct. 29, 2014)

223. As President and CEO of PFSI, the buck stopped with Yancey.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey agreed that, as a general principle**, the buck stopped with him in his position as President and CEO.
- c. Support:
  - Yancey Testimony

Q All right. Mr. Yancey, have you heard the phrase "the buck stops here"?

A Sure.

Q Would you agree that as President and CEO, the buck stops with you?

A I think as a general principle, yes.

(Hearing- Day 3, 878:20-878:25, Oct. 29, 2014)

224. If there is confusion about who is supervising an individual at a broker-dealer, the president of the broker-dealer retains the supervisory responsibility.

- a. Response: **Dispute**. The Division's statement calls for a legal conclusion.
- b. Counterstatement: *See* Yancey's Response to Division's Prop. COL 29.
  - i. Alternatively, given the cited testimony, the statement should be modified as follows:

**Poppalardo agreed that if there is confusion about delegation, the president of the broker-dealer retains the supervisory responsibility.**  
**Poppalardo testified that there was not any confusion in this case.**

- c. Support:
  - Poppalardo Testimony

Q Okay. **And you would agree with me, wouldn't you, that the law is that if a president testifies that he has delegated responsibility but there is confusion about that delegation, the president retains the responsibility for supervision?**

MS. ADDLEMAN: Objection, calls for a conclusion, legal conclusion.

JUDGE PATIL: Overruled.

A I think that -- **I think you're right, but I don't think there was any confusion in this case.** BY MS. ATKINSON:

Q But you would agree with me that the law is that if there is confusion, then the president retains the responsibility?

A If there is confusion, yes.

(Hearing- Day 8, 2038:16-2039:5, Nov. 5, 2014)

225. Until Johnson was promoted to PWI Senior Vice President for Global Stock Lending, Yancey was Johnson's supervisor.

- a. Response: **No dispute**, although the Division's statement is redundant of Stip. FOF 118 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 118 as set forth below.
- c. Support:
  - Stip. FOF 118

FOF 118.	Until Johnson was promoted to PWI Senior Vice President for Global Stock Lending, Yancey was Johnson's supervisor.
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(See Order on Stipulations)

226. Pendergraft or another PWI executive directed Johnson with respect to his global responsibilities, but did not supervise Johnson as to regulatory and compliance issues. Responsibility for supervision as to regulatory and compliance issues would have remained at PFSI.

- a. Response: **Dispute**. Testimony and other evidence controverts the Division's statement.
- b. Counterstatement: Pendergraft supervised and directed Johnson regarding all Johnson's responsibilities, including for PFSI and for regulatory and compliance.
- c. Support:
  - See Yancey's Prop. FOF 9 (Pendergraft agrees he performed supervisory activities with respect to Johnson), 10 (Pendergraft supervised Johnson with respect to regulatory and compliance issues), 14 (Pendergraft admits he supervised Johnson), 21 (Pendergraft accepted supervision of Johnson unconditionally), 22 (employees observed Pendergraft supervising Johnson) and accompanying citations and support.
  - Poppalardo Testimony

A . . . I feel really strongly that - - that you just can't parse the business activities from the regulatory requirements. . . .
---

A I've never seen it.
-----------------------

(Hearing-Day 8, 1999:8-24, Nov. 5, 2014)

- Hasty Testimony

Q Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory perspective?

A **No. I don't believe you can separate the two.**

(Hearing-Day 7, 1745:5-7, Nov. 4, 2014)

- *See also* Johnson Testimony

Q: Did you talk with Mr. Pendergraft about Reg SHO?

A: Yes.

Q: Would Reg SHO only have applicability to the broker-dealer Stock Loan function?

A: Yes.

(Hearing-Day 2, 541:17-544:10, Oct. 28, 2014)

- Pendergraft Testimony

Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question?

A: **Then I would say that I provided supervision to Mr. Johnson.**

...

**... in this time frame that Mr. Johnson reported to me, he would have largely taken his direction from me.**

(Hearing-Day 6, 1521:5-11; 1513:5-7, Nov. 3, 2014)

227. Pendergraft does not believe that Yancey delegated supervision of Johnson to Pendergraft.

- a. Response: **Dispute**. Testimony controverts the Division's statement.
- b. Counterstatement: Pendergraft admits that Johnson directly reported to him and that he supervised Johnson.
- c. Support:

- Pendergraft Testimony

Q ... At any time, so just throw the date away for a moment, do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose?

A Well, I'm sure that whenever Mr. Johnson -- **whenever I picked up that as a direct report, whenever I picked up Mr. Johnson as direct report, I'm highly confident that I talked with Mr. Yancey about it.** I don't remember a specific conversation, but I'm sure that whenever that was that **I did pick up that direct report**, I'm sure there were conversations about that.

(Hearing-Day 6, 1512:10-1512:21, Nov. 3, 2014)

**Q Did you, from 2008 to 2011, supervise Mr. Johnson in his supervision of PFSI's stock lending?**

**A Well, to the extent that Mr. Johnson provided—well, in certain ways, yes.** The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or to somebody else at the -- in the global organization.

(Hearing-Day 6, 1462:1-7, Nov. 3, 2014)

**Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question?**

**A: Then I would say that I provided supervision to Mr. Johnson.**

(Hearing-Day 6, 1521:5-11, Nov. 3, 2014)

228. It would not be inappropriate to split out regulatory and compliance supervision from operational supervision.

- a. Response: Dispute. Testimony exists that controverts the Division's statement.
- b. Counterstatement: Poppalardo testified that you cannot parse out regulatory and compliance from operational supervision.
- c. Support:
  - Poppalardo Testimony

**A . . . I feel really strongly that -- that you just can't parse the business activities from the regulatory requirements. . . .**

**A I've never seen it.**

(Hearing-Day 8, 1999:8-24, Nov. 5, 2014)

- Hasty Testimony

**Q Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory perspective?**

**A No. I don't believe you can separate the two.**

(Hearing-Day 7, 1745:5-7, Nov. 4, 2014)

229. As a practical matter, employees who had responsibilities at both PFSI and PWI could be supervised by a PWI executive for certain matters and a PFSI executive for other matters.

- a. Response: Dispute – accuracy of statement; overly broad and not supported by testimony.

- b. Counterstatement: McCain testified that, during the time he acted as interim treasurer of PWI, he reported to Pendergraft relating to responsibilities associated with financing the firm and Yancey with respect to his duties as it related to the broker-dealer items. McCain did not testify that business activities could be parsed from regulatory requirements.
- c. Support:
- McCain Testimony

Q When you were interim treasurer of PWI, did you still have duties with PFSI? A I did.  
Q And during that time period, you were still supervised by Bill Yancey, correct?  
A As it related to the broker-dealer items, that my other areas reported to Bill, yes. With financing, I felt like I reported to Phil.  
Q For the PWI interim treasurer role, did you report to Phil? Is that what you said, Mr. Pendergraft?  
A Yes.  
Q All right. So at that point in time, you reported both to Mr. Pendergraft for purposes of PWI issues and Mr. Yancey for purposes of PFSI issues?  
A I reported to Phil as it relates to the items or the responsibilities as it related to the financing in the firm, and my focus was on broker-dealer.

(Hearing- Day 9, 2202:14-2203:6, Nov. 6, 2014)

230. It would not necessarily have been obvious to PFSI employees if there had been a split in Johnson's supervision between Yancey and Pendergraft.

- a. Response: **Dispute** – accuracy of statement; overly broad and not supported by testimony.
- b. Counterstatement: Miller testified that she was unsure that she would have been aware of a split-supervisory relationship as between Yancey, Pendergraft, and Johnson.
- c. Support:
- Miller Testimony

Q If there had been a split in the supervision, if Bill had part of Mike and Phil had part of Mike, is that the kind of thing in your position that you think you would have been aware of?  
A I'm not sure that I would have been aware of that.

(Hearing- Day 11, 2588:3-2588:8, Nov. 10, 2014)

231. Numerous witnesses had different understandings of Johnson's supervision after Johnson became Senior Vice President of Stock Lending for Penson Worldwide.

- Response: **Dispute** – Testimony exists that controverts the Division's statement.
- Counterstatement: There was no confusion at Penson about who supervised Mike Johnson. Witness after witness confirmed that Pendergraft supervised Johnson.
- Support:
  - Pendergraft Testimony

Q: Here is what I want to know. It sounds to me like you're saying, Look, I dealt a lot with Mr. Johnson and I supervised Mr. Johnson, and Mr. Johnson had responsibilities at PWI Canada and he had responsibilities at PFSI Dallas, and I supervised him with respect to those responsibilities. But if—when it comes to regulatory and compliance supervision at PFSI, not me; is that fair?

A: Or at any other organization.

Q: Or at any other organization. Okay.

A: That's correct.

...

**Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question?**

**A: Then I would say that I provided supervision to Mr. Johnson.**

(Hearing – Day 6, 1519:22-1520:7, 1521:7-11, Nov. 3, 2014)

- Johnson Testimony

**Q: Did you tell them that after you were promoted to the PWI position, that the only supervisor you had was either Phil Pendergraft or Dan Son?**

**A: Yes.**

...

**Q: And [during the relevant time period], did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son?**

**A: Yes.**

(Hearing – Day 2, 537:15-18, 537:25-538:3, Oct. 28, 2014)

- Yancey Testimony

**Q: But did Phil very clearly state to you that he would be Mike Johnson's supervisor?**

**A: Yes, ma'am.**

(Hearing – Day 7, 1846:12-14 Nov. 4, 2014)

- Gardner Testimony

**Q: Who was Mike Johnson's supervisor during the time period August 2008 through November of 2011?**

**A: Phil Pendergraft.**

Q: Was Mike Johnson proud of who he reported to?

A: Yes, he was. . . he told everyone that he was . . . reporting to Phil Pendergraft at Penson Worldwide.

(Hearing – Day 4, 1149:14-16, 1152:1-6, Oct. 30, 2014)

○ McCain Testimony

**Q: Who was Mike Johnson's supervisor?**

**A: Phil Pendergraft.**

...

Q: How did you come to that understanding?

A: That's like asking why water is wet. That's just the way it was. You know, Phil told me and—and clearly, Mike made it clear to everybody that he reported to Phil. There wasn't any question as to who reported to who. If anybody had any question, Mike would set you straight real fast.

(Hearing – Day 9, 2181:19-20, 2182:10-16, Nov. 6, 2014)

○ Hasty Testimony

**Q: [Y]ou were never confused about who supervised Mike Johnson; is that right?**

**A: I was not, no.**

**Q: Okay. Who was that?**

**A: Phil Pendergraft.**

Q: And you are not aware of anyone at Penson who was confused about Mike Johnson's supervisor?

A: No.

(Hearing – Day 7, 1794:1-8, Nov. 4, 2014)

○ Delaney Testimony

Q: And did you have any ambiguity whatsoever about who Mike Johnson reported to?

A: No.

**Q: And who did Mike Johnson report to?**

**A: Phil Pendergraft.**

...

**Q: I apologize for this question, because you may have been the witness to say it, but during this trial, have you heard testimony about Mr. Johnson proudly and publicly stating that he reported only to Mr. Pendergraft?**



**A: That was my testimony and I heard other testimony that stated that.**

Q: And that, in fact, not only did he report to Mr. Pendergraft, but that he specifically and explicitly did not report to and was not was not supervised by Mr. Yancey?

A: Yes.

(Hearing – Day 5, 1216:25-1217:4, 1338:2-1338:13, Oct. 31, 2014)

○ Miller Testimony

**Q: If you had been asked by Mr. Warner in either of your prior two testimonies about who supervised Mike Johnson, what would you have told him?**

**A: He reported to Phil Pendergraft.**

(Hearing – Day 11, 2585:9-12, Nov. 10, 2014)

○ Wetzig Testimony

**Q: Were you surprised to get an instruction from Mr. Johnson that was conveying an instruction from Mr. Pendergraft?**

**A: No, sir, not at all.**

**Q: That was a fairly common occurrence, was it not?**

**A: It was common, yes, sir.**

(Hearing – Day 2, 417:7-13, Oct. 28, 2014)

○ DeLaSierra Testimony

**Q: Mr. DeLaSierra, given your personal observations and the documents we've discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson?**

**A: Yes.**

Q: Okay. And, indeed, that supervision extended to PFSI activities?

A: Yes.

(Hearing – Day 2, 302:22-303:4, Oct. 28, 2014)

○ Ex. 446 Hall Brady Letter

8. Brian Hall told the Division that Michael Johnson reported to Phil Pendergraft.

a. Yancey testified that, in August 2008, Pendergraft wanted to make Stock Loan a global product line and make Johnson the Senior Vice President for Securities Lending for PWI, and that that time Yancey fully delegated all supervisory responsibility for Johnson and for PFSI's Stock Loan department to Pendergraft.

- Response: *Dispute* – accuracy of statement.
- Counterstatement: Yancey testified that, in August 2008, Pendergraft cast a big vision for developing a global securities lending Senior Vice President role and that Pendergraft wanted Johnson to fulfill that role. Yancey agreed and Pendergraft confirmed he wanted to move Johnson and that department under his supervision. So Yancey fully delegated all supervisory responsibility for Johnson to Pendergraft without any limitations.
- Support:
- Yancey Testimony

Q [I]t is your position that you did not have a duty to supervise Mike Johnson, the head of Stock Lending, because you had delegated that duty to Phil Pendergraft?

A After August of 2008?

Q After August of 2008.

A Yes, sir.

Q How did that delegation occur, how did you do that?

A **In the summer of 2008, Mr. Pendergraft came to me and cast a big vision for developing a global security lending Senior Vice President role. Securities were lent in the United States through Penson Financial Services. In Canada, through Penson Financial Canada; and in London, through Penson Financial U.K. And his vision was that all of those similar business lines would benefit from someone that could help them with technology, with efficiencies and deep domain knowledge. And so he -- he really cast a big vision for this role that he had decided he wanted to build.**

Q And was there anything else in terms of delegating your supervision of Mike Johnson to Mr. Pendergraft?

A Yes, sir.

Q What was that?

A So Mr. Pendergraft cast this vision, and he said, and I want Mike Johnson to run that group. Mike has indicated an interest to me on a number of occasions of wanting some international opportunities, and I want to use him in that way. **I want to put him under me, he said. And I said, Phil, in light of your background, strong operational background, in light of the fact that you have a Series 27 and I do not, in -- in light of the fact that you previously had supervised this group and built this group at this firm, I think that's probably a -- a good idea.** You have close proximity; both of you are on the 19th floor, you're involved in firm financing. So this seemed entirely logical to me.

**And so I said, so you want to move him under you. And I said, is he going to continue to be engaged in Penson Financial Services matters? And he said, oh, yes. And I said, so you're going to move that department? You're going to let him continue to supervise there? Yes. Then you're going to move that department under your supervision? And he said, yes. And I said, so you become the supervisor for this whole area? And he said, yes, without any limitations.**

(Hearing- Day 4, 946:22-948:17, Oct. 30, 2014)

b. Pendergraft testified that, while he directed Johnson's activities as Senior Vice President for Global Stock Lending, he did not have supervisory responsibility over Mr. Johnson for regulatory or compliance issues, and that supervisory responsibility for those issues lay with someone at PFSI rather than Penson Worldwide.

- Response: **Dispute** – Testimony and documents contradict Division's statement.
- Counterstatement: Pendergraft directed, advised, and supervised Johnson on all aspects of his job, including at the PFSI level, and including regulatory and compliance issues.
- Support:
  - Pendergraft Testimony

Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question?

A: **Then I would say that I provided supervision to Mr. Johnson.**

(Hearing – Day 6, 1521:7-11, November 3, 2014)

- Exs. 563, 638 (emails from Johnson to Pendergraft reporting on FINRA reviews).
- Ex. 730 (email from Johnson to Pendergraft regarding easy to borrow lists and regulatory criteria).
- Ex. 813 (Pendergraft providing revisions on a Special Compliance Memorandum regarding Rule 204).
- Johnson Testimony

**Q: Did you talk with Mr. Pendergraft about Reg SHO?**

A: Yes.

**Q: Would Reg SHO only have applicability to the broker-dealer Stock Loan function?**

A: Yes

Hearing – Day 2, 541:25-542:4, Oct. 28, 2014

c. Johnson testified that he reported to Pendergraft, but that PFSI's Stock Loan department was supervised by Yancey.

- Response: **Dispute** – Testimony contradicts Division's statement.

- Counterstatement: Johnson supervised PFSI's Stock Loan department and Johnson reported to and was supervised by Pendergraft.
- Support:
  - Johnson Testimony

**Q: Did you tell them that after you were promoted to the PWI position, that the only supervisor you had was either Phil Pendergraft or Dan Son?**

**A: Yes.**

...

**Q: And [during the relevant time period], did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son?**

**A: Yes.**

(Hearing- Day 2, 537:15-18, 537:25-538:3, Oct. 28, 2014)

- Stip. FOF 55 ("Johnson oversaw securities lending activities at PFSI.")
- Yancey's Prop. FOF 9, 14, 101, and 102 and supporting evidence therein (evidence that Pendergraft supervised Johnson)
- *See, e.g.,* De La Sierra Testimony

**Q: Mr. DeLaSierra, given your personal observations and the documents we've discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson?**

**A: Yes.**

**Q: Okay. And, indeed, that supervision extended to PFSI activities?**

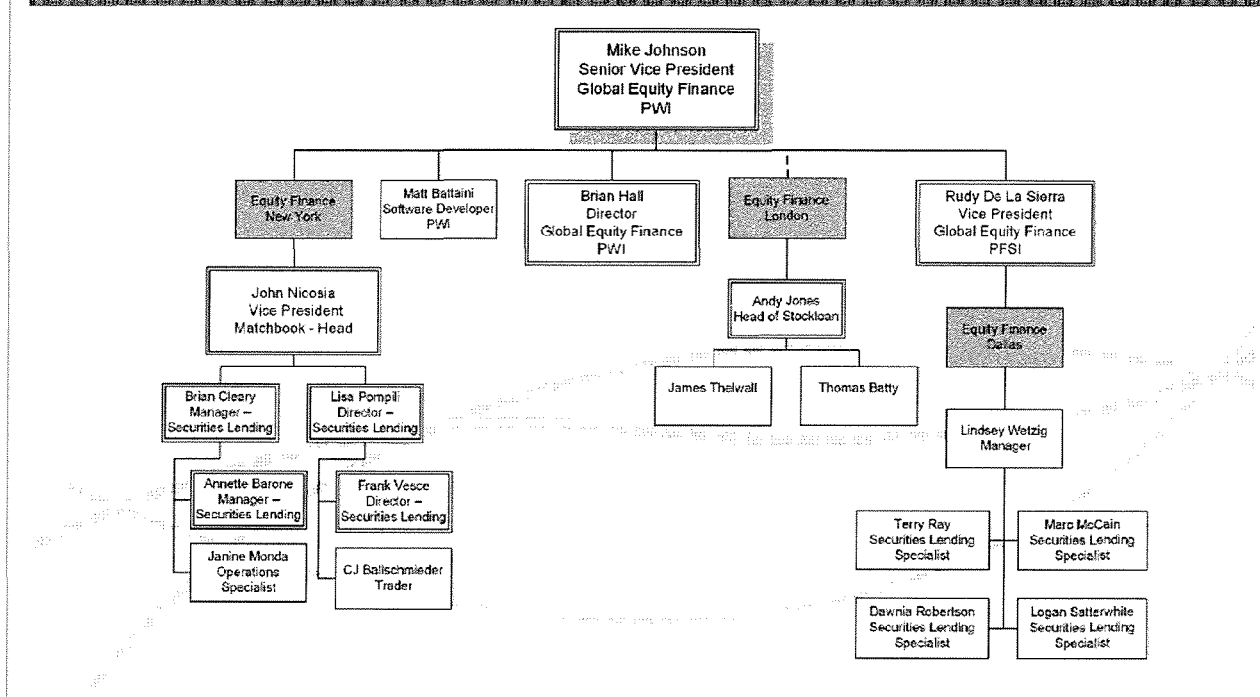
**A: Yes.**

(Hearing-Day 1, 302:22-303:4, Oct. 27, 2014)

- *See, e.g.,* Ex. 571 (2009 Organizational Chart)



## Global Equity Finance – Securities Lending



d. De La Sierra testified that he believed Johnson reported to Dan Son.

- Response: **Dispute** – other testimony contradicts Division’s statement.
- Counterstatement: DeLaSierra testified that given his personal observations and experience with supervisors, Pendergraft supervised Johnson, including as to PFSI activities.
- Support:
  - De La Sierra Testimony

Q: Mr. DeLaSierra, given your personal observations and the documents we’ve discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson?

A: Yes.

Q: Okay. And, indeed, that supervision extended to PFSI activities?

A: Yes.

(Hearing- Day 1, 286:21-286:22, Oct. 27, 2014)

*See also*, Yancey Prop FOF 6 (“Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008”) (and evidence cited therein); Yancey Prop FOF 18 (“Employees at Penson understood Michael Johnson reported to and was supervised by Phil Pendergraft”) (and evidence cited therein).

232. No one other than Yancey and Pendergraft was present for the August 2008 conversation where Yancey purportedly delegated all supervisory responsibility for Johnson and for PFSI’s Stock Loan department to Pendergraft.

- a. Response: *Dispute* – accuracy of statement; overly broad.
- b. Counterstatement: There is no evidence in the current record that anyone other than Yancey and Pendergraft was present for the August 2008 conversations where Yancey delegated all supervisory responsibility for Johnson.
- c. Support:
  - Pendergraft Testimony

Q: . . . At any time, so just throw the date away for a moment, do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose?

A: Well, I'm sure that whenever Mr. Johnson -- **whenever I picked up that as a direct report, whenever I picked up Mr. Johnson as direct report, I'm highly confident that I talked with Mr. Yancey about it. I don't remember a specific conversation, but I'm sure that whenever that was that I did pick up that direct report, I'm sure there were conversations about that.**

(Hearing-Day 6, 1512:10-21, Nov. 3, 2014)

- Yancey Testimony

Q Your conversation where you delegated to Mr. Pendergraft was sometime in August of 2008. That's your memory?

A To the best of my recollection.

Q Was anybody else in the room when that conversation happened?

A Not that I recall.

(Hearing- Day 4, 989:15-989:21, Oct. 30, 2014)

233. Pendergraft does not recall the August 2008 conversation.

- a. Response: *No dispute*.

234. Pendergraft recalls that stock lending was made a global product unit in approximately 2007.

- a. Response: **Dispute** – Testimony contradicts Division’s statement.
- b. Counterstatement: Pendergraft **does not recall when** stock lending was made a global product unit.
- c. Support:
  - Pendergraft Testimony

Q: Does 2008 generally sound like about the time that you recall Mr. Johnson moving from PFSI to PWI?

A: **I really don't remember**

(Hearing- Day 6, 1512:7-9, Nov. 3, 2014)

*See also* Yancey Prop FOF 6 (“Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008”) (and evidence cited therein)

235. Pendergraft’s interaction with the PFSI Stock Loan department did not materially change after Johnson’s promotion from Vice President to Senior Vice President; Pendergraft was always fairly involved in what PFSI Stock Loan was doing.

- a. Response: **Dispute** – evidence contravenes Division’s statement.
- b. Counterstatement: Pendergraft was involved in the affairs of the broker dealer and PFSI’s stock loan department. Pendergraft was an Executive Vice President and registered person of PFSI. Pendergraft actively supervised and frequently communicated with and directed Johnson after Pendergraft picked up Johnson as a direct report.
  - Stip. FOF 75 (“During the relevant period Phil Pendergraft was an executive vice president of PFSI.”)
  - Pendergraft Testimony

Q: . . . At any time, so just throw the date away for a moment, do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose?

A: **Well, I'm sure that whenever Mr. Johnson -- whenever I picked up that as a direct report, whenever I picked up Mr. Johnson as direct report, I'm highly confident that I talked with Mr. Yancey about it.**

. . .

Q: **Did you, from 2008 to 2011, supervise Mr. Johnson in his supervision of PFSI’s stock lending?**

**A: Well, to the extent that Mr. Johnson provided—well, in certain ways, yes.** The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or to somebody else at the -- in the global organization.

(Hearing- Day 6, 1512:10-21, 1462:1-7, Nov. 3, 2014)

*See also* Yancey Prop. FOF 18 (“Employees at Penson understood Michael Johnson reported to and was supervised by Phil Pendergraft.”) (and evidence cited therein); Yancey Prop FOF 14 (“Phil Pendergraft supervised Mike Johnson”) (and evidence cited therein); Yancey Prop FOF 6 (“Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008) (and evidence cited therein); Yancey Prop FOF 9 (describing Pendergraft’s supervision of Johnson from 2008-2011) (and evidence cited therein); Prop FOF 10 (describing Pendergraft’s supervision of Johnson from 2008-2011) (and evidence cited therein); Yancey Prop FOF 12 (describing Pendergraft’s supervision of Johnson) (and evidence cited therein); Yancey Prop FOF 13 (describing Pendergraft’s supervision of Johnson) (and evidence cited therein).

- *See e.g.*, Exs. 502; 506; 515; 517; 521; 526; 527; 528; 529; 248; 549; 550; 557; 563; 565; 573; 590; 591; 605; 607; 627; 636; 638; 664; 666; 667; 668; 670; 678; 684; 688; 707; 709; 710; 711; 726; 730; 741; 780; 783; 786; 788; 790; 791; 792; 793; 794; 795; 796; 797; 801; 803; 804; 806; 809; 813; 824 (documents evidencing Pendergraft’s constant supervision of Johnson)

236. Pendergraft interacted with Johnson with respect to Reg SHO issues in 2005, which was during the time period that Johnson was Vice President for PFSI Stock Loan and did not report to Pendergraft.

- a. Response: ***Dispute*** – accuracy of statement.
- b. Counterstatement: **One conversation in which Michael Johnson discussed Reg SHO issues with Pendergraft occurred in 2005**, which was during the time period that Johnson was Vice President for PFSI Stock Loan.
- c. Support:
  - Johnson Testimony

Q Mr. Johnson, one of the things that Mr. Yancey's counsel was asking you about was prior testimony that you gave, and the question and answer was: Question: Tell me about the communications with Mr. Pendergraft about Reg SHO.  
The answer was: I think that Reg SHO was, quote, hey, Phil, I'm sitting here and you're not doing anything about it. Do you know the rules? So I need a check for 150,000 to do something with it, to try to work with Jill Zacha and other people -- it wasn't all me -- and to put some in place to comply with Reg SHO.  
Do you recall discussing that with Mr. Yancey's counsel?  
A Yes.



Q Do you recall the context of this conversation with Mr. Pendergraft and asking for 150,000?

A Yes.

Q What was it?

A Jill Zacha, at that time, ran Legal and Compliance for PFSI, and I was just hired in. And at this point, I reported to Rich Hart; Mr. Yancey wasn't there, I don't believe. They -- I said, what are you doing? Because I just came from SunGard, and I said, what are you doing for the -- it was to go live January 3rd of that year, and nobody knew anything about it. So I'm trying to get the firm into compliance with this rule and build a system with a gentleman named Rob Sammons, which we completed and got in on that date.

Q And was that system called Sendero?

A I'm not sure if it was at that time, but it was what was the catalyst for Sendero.

Q I see. And you said, I think, Reg SHO was to come in on January 3rd of that year. Do you recall which year?

A I think 2005 would be the January 3rd, because I think I started August or September 1st of 2004. And this was a big rule; it was to give locates, et cetera, and there was nothing done when I got there.

Q And at the time of this conversation, who, again, did you say you reported to?

A I reported to Richard Hart, who ran operations.

(Hearing- Day 2, 564:6-565:21, Oct. 28, 2014)

237. There is no document evidencing that Yancey delegated full supervisory responsibility from Johnson to Pendergraft.

- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: Bill Yancey delegated supervision of Michael Johnson to Pendergraft in approximately August 2008, as evidenced in many documents.
- c. Support:
  - See Yancey Prop. FOF 6 (and support cited therein)
  - See e.g., Exs. 502; 506; 515; 517; 521; 526; 527; 528; 529; 248; 549; 550; 557; 563; 565; 573; 590; 591; 605; 607; 627; 636; 638; 664; 666; 667; 668; 670; 678; 684; 688; 707; 709; 710; 711; 726; 7.30; 741; 780; 783; 786; 788; 790; 791; 792; 793; 794; 795; 796; 797; 801; 803; 804; 806; 809; 813; 824 (documents evidencing Pendergraft's constant supervision of Johnson)
  - Compare Ex. 555 (PFSI Executive Team chart showing Michael Johnson under Bill Yancey pre-2008) with Ex. 571 (Jan. 2009 organizational chart showing Johnson not under Yancey, but under Phil Pendergraft)
  - Ex. 608 (email from Phil Pendergraft to Dawn Gardner directing her to move Mike Johnson to PWI payroll)

**From:** Phil Pendergraft  
**Sent:** Thursday, August 14, 2008 9:32 AM  
**To:** Dawn Gardner  
**Subject:** Mike Johnson

Dawn:

Effective with the 8/31 payroll, Mike Johnson should be moved to PWI payroll, and his salary adjusted to 600k per year.

Thanks

Phil

238. The August 2008 e-mail transferring Johnson's payroll from PFSI to PWI does not mention supervision.

a. Response: *No dispute.*

239. Several witnesses testified that PFSI's organizational charts clearly showed that Johnson was supervised by Pendergraft.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: Several witnesses testified that **they relied on** PFSI's organizational charts to determine the supervisory structure **and that those charts showed** Johnson was supervised by Pendergraft.

c. Support:

- Miller Testimony

Q: Are you aware of anyone at Penson that was ever confused from this document, or as a result of this document, about who supervised Mike Johnson?

A: I wouldn't think so. **I would think that people at the firm typically referred to a human resources org chart rather than this document.**

(Hearing-Day 11, 2597:19-24, Nov. 10, 2014)

- Hasty Testimony

**Q: If you wanted to know who someone's supervisor was, what document would you reference? A: I would use the org charts.**

(Hearing-Day 7, 1748:1-3, Nov. 4, 2014)

- Yancey Testimony

Q You also looked with Ms. Addleman at a few org charts. Do you recall that?

A Yes.

Q And I think you said something along the lines of the org charts are clear. It shows a hard line to the supervisor. Does that sound right?

A Yes.

(Hearing- Day 7, 1916:20-1917:1, Nov. 4, 2014)

**Could anyone by looking at this org chart tell that Mike Johnson reported to Phil Pendergraft?**

**A I could.**

(Hearing- Day 7, 1917:23-1917:25, Nov. 4, 2014)

Q The cover page here [of Exhibit 513] shows an e-mail from Hillary Hinson to Eric Alaniz dated June 29th, 2009. Do you see that?

A I do.

**Q And if you will go to the PWI page with Phil, Rocky, and Dan at the top. Do you see that?**

**A Yes, ma'am.**

**Q To whom does Mike Johnson report on this page?**

**A To Phil Pendergraft.**

(Hearing- Day 7, 1853:7-1853:18, Nov. 4, 2014)

- Delaney Testimony

Q: And when you wanted -- if in your work, if you need to know who reported to whom, was there anything that you referred to?

**A: There were documents that the -- that the company had that gave us information about who reported to who, the org -- company org charts.**

(Hearing-Day 5, 1215:11-16, Oct. 31, 2014)

Q And was Mike Johnson at that time transitioned from the broker-dealer, PFSI, to the PWI parent entity?

A Yes.

Q And how do you know that?

**A Well, I've certainly seen my fair share of org charts and -- but it was common knowledge.**

**Q Okay. Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson?**

**A Yes.**

(Hearing- Day 5, 1331:22-1332:7, Oct. 31, 2014)

**Q And I think that you said that the reason that you knew that Mr. Johnson reported to Mr. Pendergraft was because of these org charts; is that right?**

**A I believe it was that and that it was just widely understood.**

(Hearing- Day 5, 1396:22-1397:1, Oct. 31, 2014)

- McCain Testimony

Q In your mind, is this org chart clear?

A It is.

Q Is it confusing in any way?

A Not that I can see, no.

(Hearing- Day 9, 2194:5-2194:8, Nov. 6, 2014)

Q Mr. McCain you, discussed this org chart, Exhibit 622, with Ms. Addleman, and I would like to again go to the page that showed the PWI structure.

...

Q Mr. McCain, do you believe someone just looking at this org chart could tell that Mike Johnson reported to Phil Pendergraft?

**A I think anybody within Penson that saw this org chart would see this and understand that Mike reports to Phil Pendergraft.**

Q And how would they know that from this org chart?

A They just know it.

Q Like water is wet?

A Yes. Everybody knew that. I cannot make that more clear. That is the way it was.

Q We could agree that this org chart says that Mr. Johnson reports to Son, correct?

A I see that -- the parenthetical in Mike's box there. But, again, when you're in Penson, you know really what all of that means.

(Hearing- Day 9, 2209:4-2210:1, Nov. 6, 2014)

240. PFSI's organizational charts, which were maintained by the Human Resources department, show Johnson reporting to Dan Son.

- a. Response: ***Dispute*** – accuracy of statement.
- b. Counterstatement: PFSI's organizational charts **for the relevant period**, which were maintained by the Human Resources department, show Johnson reporting to **Dan Son, Phil Pendergraft, and Roger Engemoen with a notation (reporting to Son). None show Johnson reporting to Yancey.**
- c. Support:
  - See, e.g., Exs. 503, 513, 514, 520, 570

- Yancey Testimony

Q It's an org chart, as you see, dated January 9th, 2009. Do you recognize this?  
A I recognize the cover.  
...  
Q And where do you see Mike Johnson there?  
A I see him in the lower left part of the diagram.  
Q And he was reporting up to -- **it looked like he was reporting up to all three people there, Dan Son, Rocky Engemoen, and Phil Pendergraft; is that correct?**  
A **No.**  
Q **Tell me what's wrong with that.**  
A **Not a great illustration, perhaps. There was one person of those three at the top who was widely recognized as doing the vast, vast majority of the -- of the jobs associated with those positions, and it was Phil Pendergraft.**  
  
(Hearing- Day 7, 1846:25-1847:19, Nov. 4, 2014)  
  
Q And to answer my question, it's very simple. Could anyone by looking at this org chart tell that Mike Johnson reported to Phil Pendergraft?  
A I could.  
Q Could anyone without intimate knowledge of PFSI tell that?  
A I don't know.  
Q **How could you tell from this org chart that Mike Johnson reported to Phil Pendergraft?**  
A **Because I knew it was reporting to him.**  
Q You would agree with me that this org chart says he reports to Mr. Son, correct?  
A I see there's a notation in his box like that.  
  
(Hearing- Day 7, 1917:22-1918:10, Nov. 4, 2014)

241. The organizational charts do not clearly show that Johnson was supervised by Pendergraft.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: PFSI's organizational charts **for the relevant period**, which were maintained by the Human Resources department, show Johnson reporting to **Dan Son, Phil Pendergraft, and Roger Engemoen with a notation (reporting to Son). None show Johnson reporting to Yancey.**
- c. Support:
  - Yancey Testimony

Q It's an org chart, as you see, dated January 9th, 2009. Do you recognize this?  
A I recognize the cover.

...

Q And where do you see Mike Johnson there?

A I see him in the lower left part of the diagram.

Q And he was reporting up to -- **it looked like he was reporting up to all three people there, Dan Son, Rocky Engemoen, and Phil Pendergraft; is that correct?**

A No.

Q Tell me what's wrong with that.

A Not a great illustration, perhaps. There was one person of those three at the top who was widely recognized as doing the vast, vast majority of the -- of the jobs associated with those positions, and it was Phil Pendergraft.

(Hearing- Day 7, 1846:25-1847:19, Nov. 4, 2014)

Q And to answer my question, it's very simple. Could anyone by looking at this org chart tell that Mike Johnson reported to Phil Pendergraft?

A I could.

Q Could anyone without intimate knowledge of PFSI tell that?

A I don't know.

Q **How could you tell from this org chart that Mike Johnson reported to Phil Pendergraft?**

A **Because I knew it was reporting to him.**

Q You would agree with me that this org chart says he reports to Mr. Son, correct?

A I see there's a notation in his box like that.

(Hearing- Day 7, 1917:22-1918:10, Nov. 4, 2014)

- Delaney Testimony

Q And was Mike Johnson at that time transitioned from the broker-dealer, PFSI, to the PWI parent entity?

A Yes.

Q And how do you know that?

A **Well, I've certainly seen my fair share of org charts and -- but it was common knowledge.**

Q **Okay. Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson?**

A Yes.

(Hearing- Day 5, 1331:22-1332:7, Oct. 31, 2014)

Q And I think that you said that the reason that you knew that Mr. Johnson reported to Mr. Pendergraft was because of these org charts; is that right?

A I believe it was that and that it was just widely understood.

(Hearing- Day 5, 1396:22-1397:1, Oct. 31, 2014)

242. Even after Yancey became CEO of PFSI, Pendergraft remained very active in PFSI issues and interacted with PFSI employees that he did not supervise.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: Even after Yancey became CEO of PFSI, Pendergraft remained active in certain PFSI issues and interacted with PFSI employees.
- c. Support:
  - Pendergraft Testimony

Q Did you have occasion, while you were in the office at -- in PFSI's office, to interact with PFSI staff?

A Well, Penson had multiple floors in the building. The Penson Worldwide executive offices were on one floor, the same floor as Stock Loan and the trading department and compliance, and -- but the firm's operations, PFSI operations was on a different floor. And so I would -- yes, any day I was in the office, I would likely be -- have business on all of the floors and walking around visiting with people.

Q Okay. Mr. Delaney testified that people would frequently come to you for advice and things like that; is that a fair characterization?

A Yes, probably so.

(Hearing- Day 6, 1596:1-15, Nov. 3, 2014)

- Delaney Testimony

Q And it wasn't unusual for all kinds of people to go into Mr. Pendergraft's office for advice; isn't that true?

A I don't know that -- I don't know specific -- I -- **I very rarely went into Mr. Pendergraft's office. It was generally on invitation. I -- I don't know how often others went in to get advice from him.**

(Hearing- Day 3, 695:11-696:17, Oct. 29, 2014)

- Gover Testimony

A I can provide -- I could say examples probably across a multitude of my teams where you would get a call from Phil saying, "I want to do this," or "I got an escalation from a customer and he said you made this policy change" or -- just very, very hands-on and very active in making decisions.

Q Okay. And how often would he do that?

A **You know, my interactions with him, it would really kind of vary depending on what the functions were.** But there were times during 2011, 2012 when I had most of the treasury functions where it was an everyday thing. But he was -- you know, he didn't just swoop in occasionally. Phil would -- Phil knew the business.

(Hearing- Day 1, 196:10-22, Oct. 27, 2014)

- Wetzig Testimony

Q And was Mr. Pendergraft involved in the business during the whole time that you worked at Penson?

A **Mr. Pendergraft was always interested in our P&L.**

(Hearing- Day 2, 412:3-412:6, Oct. 28, 2014)

- De La Sierra Testimony

Q **Were you ever in conversations with Phil Pendergraft?**

A **Regarding financing is the about the only conversations I ever had with Phil Pendergraft.**

Q I see. Regarding financing. How about -- were you ever copied on e-mails? I think we saw some copied on e-mails with Phil Pendergraft.

A Yes, I was.

Q Would -- did those involve financing issues?

A Occasionally, yes.

(Hearing- Day 2, 334:14-23, Oct. 28, 2014)

- Yancey Testimony

Q You also spoke with Ms. Addleman about your observations of Mr. Pendergraft speaking to Mr. Johnson when they were both in the office. Do you recall that?

A Yes.

Q Was Mr. Pendergraft the only person you -- excuse me. Was Mr. Johnson the only person you ever saw Phil Pendergraft talking to?

A No.

Q Did he talk to lots of PFSI employees?

A Yes.

Q Did you observe him talking to other PSI employees?

A From time to time.

Q And I don't think it's your testimony, but you're not saying that Mr. Pendergraft was the supervisor of everyone he talked to, are you?

A No.

(Hearing- Day 7, 1919:21-1920:12, Nov. 4, 2014)

- McCain Testimony

A I would agree that -- that Phil was actively involved in many areas. If you want to call that Philcentric, you can call it Philcentric. **But his -- when it comes to PFSI, my recollection of him being involved was largely focused on Stock Loan and finance, and the rest of his time**



**was on the other operating companies.**

(Hearing- Day 9, 2212:16-2214:24, Nov. 6, 2014)

243. Pendergraft was involved in the supervision of all aspects of PFSI.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: **McCain testified that** Pendergraft was involved in the supervision of all aspects of **all operating companies, not just PFSI**.
- c. Support:
  - McCain Testimony

Q And he was not sending it to you because he was your supervisor; is that fair?

A That's correct.

Let me make -- let me make another comment here.

Q Yes, sir.

A Phil was not my direct supervisor, but *Phil was involved in the supervision of all aspects of the operating company, all operating companies, not just PFSI*, but London, Canada, Australia, Nexa. So it wouldn't be unusual at all for him to ask this question of a senior manager, and I would be surprised if he didn't.

Q It wouldn't be unusual for him to ask that question whether he their direct supervisor or not; isn't that fair?

A Yes.

(Hearing- Day 9, 2219:19-2220:10, Nov. 6, 2014)

244. Pendergraft gave final approval for bonuses at all PFSI departments, not just the Stock Loan department.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: Generally, copies of all the bonus recommendations would be given to Pendergraft for his review and McCain testified that his expectation was that Pendergraft gave the final approval.
- c. Support:
  - McCain Testimony

Q Mr. McCain, you spoke with Ms. Addleman briefly about an e-mail, and I apologize, I don't recall the exhibit, but it was about Phil approving bonuses for Stock Lending. Do you recall generally that conversation?

A I do, yes.

Q Do you recall if Mr. Pendergraft had to approve commissions or bonuses for other PFSI

departments, not just Stock Lending?

A **Generally, all of the bonus recommendations were, once they were approved by Phil, by Bill, and then they would be -- copies would be given to Phil for his review.**

Q **And would he be the final approver?**

A **I would expect that he would be, yes.**

(Hearing- Day 9, 2225:21-2226:10, Nov. 6, 2014)

245. Pendergraft had personal relationships with PFSI customers and would converse with various PFSI and Penson Worldwide employees, including Mike Johnson, with questions related to those relationships.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: Pendergraft had personal relationships with **some** PFSI customers and would converse with various PFSI and Penson Worldwide employees, including **De La Sierra** and Johnson, with questions related to those relationships.
- c. Support:
  - Johnson Testimony

Q And can you describe, did Mr. Pendergraft have personal relationships with lots of people on the street?

A Lots of people on the street, as well as lots of the -- you'll have to remember, before Bill Yancey, Phil -- this was his company before he went public, so, therefore, these customers didn't care about me or Bill. They go to him; they went to Phil Pendergraft.

...

Q All right. **And would Phil occasionally come to you to ask you to follow up on something for one of these personal relationships that Phil had?**

A **Yes.**

Q Did that happen all the time?

A Yes.

(Hearing- Day 2, 566:10-567:1, Oct. 28, 2014)

Q This is from yourself to Phil Pendergraft, dated May 18, 2010, and it says, Bob Jersey wants to know when and rate on all borrows we do not -- sorry -- we do that cover his short positions. And then in the last sentence there, you say, "We only allocate HTB, and he receives that. Let me know how to proceed."

Do you see that?

...

Q In what context were you communicating with Mr. Pendergraft in this e-mail?

A **Bob Jersey was a personal relationship with Phil; he went to Rudy De La Sierra asking for this information. Rudy came to me; he was uncomfortable giving it out because this is corporate P&L stuff. And I went to Phil saying, well, this is your guy. What do you want**

to do?

(Hearing- Day 2, 548:9-549:11, Oct. 28, 2014)

Q You say in the top e-mail -- you write back, and now you copy Rudy. And you say, "We have and they seem not to meet our regulatory criteria." What -- do you know what that refers to?

A Yes.

Q Can you elaborate?

A Yes. Those various rules to build a need to borrow, an ETB list. And we were very stringent and strict because we tried to follow all regulatory rules. And this customer went above us to Phil Pendergraft, because of the relationship of this -- they had a big financial relationship, Lightspeed and PWI and PFSI. And he's trying to get more items on the list, which Rudy would do, but they were yelling at him, so he bumped it to Global for me to take care of it.

Q Okay. So Phil -- and then Phil was then downstreaming it back to you?

A Yes.

(Hearing- Day 2, 559:12-560:4, Oct. 28, 2014)

246. Johnson received approximately 300 e-mails per day when he was Senior Vice President for Global Stock Lending.

- a. Response: *No dispute*, although the Division's statement is redundant of Stip. FOF 119 previously stipulated to by all parties and there is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 119 as set forth below.
- c. Support
  - Stip. FOF 119

FOF 119. Johnson received approximately 300 e-mails per day when he was PWI Senior Vice President for Global Stock Lending.

(See Order on Stipulations)

247. Pendergraft sent others, including Bart McCain, e-mails on topics including PFSI firm financing, revenue, and regulatory issues.

- a. Response: *Dispute* - overly broad.

- b. Counterstatement: McCain testified that he corresponded with Pendergraft regarding firm financing when McCain served as interim treasurer and interim CFO of PWI. Some documents reveal those communications extended to revenue and regulatory issues.
- c. Support:
  - McCain Testimony

A . . . And also in 2011, Phil Pendergraft asked me to assume the role as interim treasurer for the entity, and my primary responsibilities there were to help financing of the firm.

(Hearing-Day 9, 2161:13-16, Nov. 6, 2014)

Q You would communicate with Mr. Pendergraft about business issues; is that fair?

A It is, when it was something that related to the areas that I interacted with him on.

Q And you would communicate with Mr. Pendergraft about things like firm financing; is that fair?

A It is.

(Hearing- Day 9, 2215:18-2215:25, Nov. 6, 2014)

- Ex. 265

**To:** Brian Gover[BGover@PENSON.COM]; Mark Fawver[MFawver@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]; Tom Delaney(TDelaney@PENSON.COM]  
**From:** Phil Pendergraft  
**Sent:** Wed 8/12/2009 8:32:34 AM  
**Importance:** High  
**Subject:** Ren call

**Guy**s

I would like to push this call back until early tomorrow or Friday morning so that I can participate. Do you think this will be a big deal to them? Have we committed to the regulators that we will do this today? Please let me know asap.

**Thanks**

**Phil**

- Ex. 266

**To:** Tom [REDACTED] COM]  
**From:** Bart  
**Sent:** Thur 11/12/2009 11:00:06 PM  
**Importance:** Normal  
**Subject:** Fwd: blue sheet

Tom,  
Can you and I discuss the charge for Blue Sheet requests? And could you have someone look into why MBT's charges are running at the level Steve mentions below? I need to respond to Phil's email below and want to fully understand this charge before doing so.

Thanks.

Bart

**Sent:** Thu Nov 12 18:44:10 2009  
**Subject:** blue sheet

Hi Phil,

We are getting billed due to regulatory requests to pull blue sheets at \$25 per request. This has caused MBT to get billed about 5-6k per month from these charges. This has gone on for several months. I certainly don't have an issue with an actual cost of the resource to do this but this is now becoming really expensive. At this rate we can just hire someone full time to only handle the MBT requests for less than we are paying now. Would you consider a reduction in this blue sheet charge to \$5 per request? Thanks for your consideration and hope all is well.

Regards,

Steve

- Ex. 267

**On Nov 5, 2010, at 11:02 AM, Phil Pendergraft wrote:**

**Bart**

**Can we get a revenue estimate for BPS for yesterday?**

**Thanks**

**Phil**

- Ex. 268

**To:** Phil Pendergraft(ppendergraft@penson.com)  
**Cc:** Bill Yancey(BYancey@PENSON.COM); Kevin McAleen(KMcAleen@PENSON.COM)  
**From:** Bart McCain  
**Sent:** Sat 11/20/2010 1:24:18 PM  
**Importance:** Normal  
**Subject:** Re: Pinnacle

**Phil,**

Thought the call went well. They told us of the customers they lost which were attributed to concerns around our financials. I gave them the talking points you provided me during the MBR and Kevin expanded on those (and I thought did an outstanding job). Further, we offered to visit with any of their customers that raised similar concerns.

All in all, they seemed satisfied when the call ended. Their RM, Ryan Dill, participated in the call. Afterward, I asked him to stay close to Pinnacle and to keep me up on their temperature so that we could be proactively sensitive/helpful to them.

Have a safe trip to Asia. See you next week.

**Bart**

- Ex. 269

**From:** Phil Pendergraft <ppendergraft@person.com>  
**Date:** Tue, 7 Dec 2010 13:54:30 -0600  
**To:** Bart McCain <bmccain@person.com>, John Kenny <jkenny@person.com>  
**Subject:** 80010317

Gents

This is a Person Financial account with a negative equity of about 400k....can you look at this please?

Thanks

Phil  
--\_000\_2416b705f49e4785bef5487fd0085cb8journal/reportgenerato

- Ex. 270

**From:** Bart McCain <[REDACTED]@PENSON.COM>  
**Sent:** Friday, December 10, 2010 7:11 PM (GMT)  
**To:** Phil Pendergraft <[REDACTED]@person.com>; John Kenny <[REDACTED]@PENSON.COM>  
**Subject:** Response to FINRA - Important

---

Phil,  
We have to respond to FINRA today on a matter but want to get your feedback before doing so. Is there a time that works for you, bearing in mind that John has to leave for the airport by 2? He'll be available by cell until his flight leaves at 4.

We're in the planning meeting in the learning center so either call me or respond, and we'll call you.

Bart

248. Pendergraft did not send these e-mails to Bart McCain as McCain's supervisor.

- a. Response: *No dispute.*

249. Pendergraft was not Bart McCain's supervisor for purposes of Bart McCain's PFSI responsibilities; Yancey was Bart McCain's supervisor for such purposes.

- a. Response: *Dispute* - overly broad and not supported by cited testimony.
- b. Counterstatement: Yancey was Bart McCain's supervisor.
- c. Support

- Yancey Testimony

Q And who -- I'm not sure if we talked about it. Who is Bart McCain?  
 A Bart McCain was the Chief Administrative Officer of the firm.  
 Q **Was he a direct report to you?**  
 A **Yes.**  
 Q Okay. You didn't delegate the supervision of Mr. McCain to Phil Pendergraft, right?  
 A I'm sorry?  
 Q You did not delegate supervision of Mr. McCain to Phil Pendergraft; is that right?  
 A I did not.

(Hearing- Day 4, 952:14-952:25, Oct. 30, 2014)

- McCain Testimony

Q Let's talk about the supervision structure at Penson Financial. **You mentioned you reported to Bill Yancey; is that correct?**  
 A **Yes.**

(Hearing- Day 9, 2177:21-2177:24, Nov. 6, 2014)

250. Johnson communicated with others, including Bart McCain, on topics including Stock Loan revenues, firm financing, travel schedule, and expense approval.

- a. Response: **Dispute** – accuracy of statement; overly broad given cited support.
- b. Counterstatement: Johnson **had some communications with senior PFSI and PWI executives**, including Bart McCain, on topics including Stock Loan revenues, firm financing, travel schedule, and expense approval.
- c. Support:
  - Ex. 338



**From:** Mike Johnson  
**Sent:** Thursday, December 02, 2010 11:02 AM  
**To:** Daniel Son; Rocky Engemoen; Bill Yancey; Bart McCain; Kevin McAleer; Bryce Engel; John Skain; Clive Triance; Michael Gallian; Phil Pendergraft  
**Subject:** As of Last Night Close

DAILY GLOBAL P&L		MTD
Dallas 234	37,159.87	37,156.23
Dallas 158	9,950.80	9,950.80
New York	6,298.88	6,298.88
London 80/20	3,128.07	3,128.07
Toronto (USD)	6,754.07	6,754.07
Total Daily Global P&L	63,291.69	63,288.06

- Ex. 271

**From:** Mike Johnson <mjohnson@PENSON.COM>  
**Date:** July 26, 20  
**T** Bill Yancey <[REDACTED]@PENSON.COM>, Bart McCain  
<[REDACTED]@PENSON.COM>

I am estimating NYC to come in around 222K for July

I am estimating the income for Dallas to be 1,135,000

Thanks

- Ex. 272

**From:** Bart McCain <bm[REDACTED]@PENSOC.COM>  
**Sent:** Monday, October 25, 2010 9:45 PM  
**To:** Mike Johnson <[REDACTED]@PENSOC.COM>; Brian Hall  
**Subject:** Firm financing

---

Were we able to pull back on financing today?

- Ex. 273

---

**From:** Bart McCain  
**Sent:** Sunday, November 14, 2010 9:36 AM  
**To:** Mike Johnson  
**Subject:** Re:  
**Importance:** High

MJ,  
How much of PFST's capital does London use each day?

On Nov 14, 2010, at 8:59 AM, Mike Johnson wrote:

I know that you have been asked to adjust the split with London on the business at hand. We currently do 80 percent to them and 20 to PFST. I do not want to change it as we are still repairing things and until I see it running correctly I don't think we should change.

Thanks

m

- Ex. 274

**From:** Mike Johnson <m[REDACTED]COM>  
**Sent:** Monday, October 25, 2010 5:26 PM  
**To:** Bart McCain <bm[REDACTED]COM>  
**Cc:** Li [REDACTED]ENSON.COM>; Rudy De La Sierra  
<[REDACTED]COM>  
**Subject:** [REDACTED]

---

Bart,

May I have approval for a quick dinner under 400.00 and four tickets to the Dallas stars game? Our largest client Bank of America is coming to visit TD Ameritrade and they have asked us to take them to the Stars. The Stars tickets will be under 75.00 each. (4) total expense of 700.00

Thanks

- Ex. 275

**From:** Bart McCain <bm[REDACTED]COM>  
**Sent:** Wednesday, January 12, 2011 3:29 PM  
**To:** Mike Johnson <m[REDACTED]COM>  
**Subject:** Re: Re: RE:

---

Will do, Mike. Safe travels!

On Jan 12, 2011, at 8:53 AM, "Mike Johnson" <m[REDACTED]COM> wrote:

I am enroute to nyc I can see avatar tomorrow if needed. Please see rudy to understand the ridge issues and regulatory guidelines we are following.

M

251. Bart McCain was not Johnson's supervisor, and none of the e-mail communications on topics including Stock Loan revenues, firm financing, travel schedule, and expense approval made McCain Johnson's supervisor.

- a. Response: Dispute. The Division's statement consists of impermissible argument in violation of the Post-Hearing Order and should be stricken.
- b. Counterstatement: Bart McCain was not Johnson's supervisor.
- c. Support:
  - Johnson Testimony

Q: Did you tell them that after you were promoted to the PWI position, that the only supervisor you had was either Phil Pendergraft or Dan Son?

A: Yes.

...

**Q: And [during the relevant time period], did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son?**

**A: Yes.**

(Hearing- Day 2, 537:15-18, 537:25-538:3, Oct. 28, 2014)

252. If Yancey personally communicated with regulators about information within his knowledge, he was confident that it was accurate.

- a. Response: ***Dispute*** – accuracy of statement.
- b. Counterstatement: **Yancey testified that when** he personally communicated with regulators about information within his knowledge, he was confident that it was accurate.
- c. Support:
  - Yancey Testimony

Q And Mr. Yancey, if you personally were communicating with regulators, you would strive to be accurate; isn't that fair?

A Yes.

Q And you would strive to be honest?

A Sure.

Q In your time as CEO of Penson, do you believe you were honest in your communications with regulators?

A Yes, sir.

Q Do you believe you were accurate in your communications with regulators?

A To the extent of my knowledge.

**Q All right. If you knew something and you told it to regulators, it was something within your knowledge, you were confident it was accurate?**

**A Yes, sir.**

(Hearing- Day 3, 881:20-882:10, Oct. 29, 2014)

253. In March 2011, Yancey personally signed PFSI's 2011 CEO Certification. Attached to that certification was the annual summary report, prepared by the Compliance department. Yancey knew this was an important report that was going to regulators, and he reviewed it before signing the certification.

- a. Response: ***No dispute.***

254. Bart McCain believed the 2011 annual summary report was accurate.

a. Response: *No dispute.*

255. In the report attached to the 2011 CEO Certification, Johnson is listed as the supervisor of PFSI's Stock Loan department, and is described as being part of the "senior directors team" that meets weekly to report to Yancey.

a. Response: *No dispute.*

256. PFSI's Written Supervisory Procedures ("WSPs") were an important document, and a source of information for PFSI's regulators.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: **Yancey agreed that** PFSI's Written Supervisory Procedures ("WSPs") were an important document, and a source of information for PFSI's regulators.

c. Support:

- Yancey Testimony

Q Would you also agree that WSPs were a source of information for regulators about Penson's processes?

A Yes, sir.

(Hearing- Day 3, 886:11-886:13, Oct. 29, 2014)

Q They were an important document?

A They were.

(Hearing- Day 3, 886:17-886:18, Oct. 29, 2014)

257. It was important to Yancey that PFSI's WSPs be as accurate as possible.

a. Response: *No dispute.*

258. PFSI's WSPs contained a section designating supervisors. That section was at the very front of the WSPs. The section of the WSPs designating supervisors referenced and incorporated PFSI's supervisory matrix.

a. Response: *No dispute.*

259. PFSI's WSPs did not incorporate any org chart.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Poppalardo, an expert witness, agreed that, of the WSPs she reviewed, PFSI's WSPs did not incorporate any org chart. Notwithstanding Poppalardo's testimony, the WSPs do in fact reference the org chart for reporting purposes.**
- c. Support:
  - Ex. 188, at 180 (directing team members to the organizational chart to determine reporting chain for senior management)

The team member receiving the initial information or contact shall report directly to their department manager as soon as possible, but no later than the same day the specific information concerning the account holder's identity. If for some reason the manager is not available, the team member should proceed up the departmental organization chart to the next Senior Manager. The team member's only responsibility is the timely, accurate

- Poppalardo Testimony

Q And it sounds to me like you have looked at a lot of WSPs for PFSI; is that right?  
A Yes.  
Q Or did you only look at one set?  
A No, actually, I -- you know, in making an assessment of their supervisory system, I felt compelled to review most of them.  
Q Okay. And at least as far as the exhibits that have been offered by Mr. Yancey, no WSP incorporates an org chart; isn't that true?  
A That's true.

(Hearing- Day 8, 2028:16-2029:1, Nov. 5, 2014)

260. The purpose of PFSI's supervisory matrix was to identify the supervisor for each of PFSI's registered employees.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Miller testified that PFSI's supervisory matrix was maintained in order to keep track of the identified supervisor for each of PFSI's registered employees.**
- c. Support:
  - Miller Testimony

Q How did that relate to your job of keeping the matrix document up-to-date, if at all?  
A Anytime a new employee would come on or anytime someone would obtain a new license, I

would try to update that document so that it identified the person that was managing them and, you know, sort of --

...

Q And we talked about it briefly in the beginning. This document, this registered representative supervisory matrix, you -- that's a document you know? A Yes, sir.

Q It's a document that you kept?

A Uh-huh. Yes.

Q Tell us what -- why you kept it and what it was used for within Penson.

A **We're required to designate a supervisor and identify that supervisor for each of our registered employees. So we maintain that matrix in order to try to keep track of that.**

(Hearing- Day 11, 2589:5-2590:11, Nov. 10, 2014)

261. PFSI's supervisory matrix listed employees **under various executives**.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: PFSI's supervisory matrix listed employees **under various other employees**.
  - *E.g.*, Ex. 177 (not limited to executives)

262. For the time period relevant to this case, Johnson was always listed under Yancey in PFSI's supervisory matrix.

- a. Response: **Dispute** – accuracy of statement. Division's statement is also redundant of Stip. FOF 37 previously stipulated to by all the parties. There is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 37 as set forth below.
- c. Support:

FOF 37. From 2009 to 2011, the Registered Representative Supervisory Matrix listed Bill Yancey under the column titled Regulatory Supervisor with regard to Michael Johnson.

(See Order on Stipulations)

263. For the time period relevant to this case, Johnson was never listed under Pendergraft in PFSI's supervisory matrix.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: Johnson was not separately listed under Pendergraft in the PFSI supervisory matrices admitted into evidence.

264. PFSI's supervisory matrix contained a column for an employee's "Regulatory Supervisor" and his or her "Pi Org Chart Supervisor."

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: PFSI's supervisory matrix contained a column **titled** "Regulatory Supervisor" and "Pi Org Chart Supervisor."
- c. Support:
  - *E.g., Ex. 177*

265. The "Regulatory Supervisor" was PFSI's assignment of supervisors for purposes of NASD Rule 3010, which requires a firm to provide for the assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who "shall be responsible for supervising that person's activities." (Poppalardo; Miller; Rule 3010(a)(5)).

- a. Response: **Dispute** – Evidence cited by Division does not support the statement.
- b. Counterstatement: **Miller testified that she believed that the "regulatory supervisor" column "dealt with" NASD Rule 3010.**
- c. Support:
  - Miller Testimony

Q Then what did the Regulatory Supervisor column mean, in your words?  
A That would be the person that was responsible for regulatory supervision of that individual.

(Hearing- Day 11, 2591:9-2591:13, Nov. 10, 2014)

**And the Regulatory Supervisor column was the column that dealt with the NASD Rule 3010 supervisor, right?**

**A Correct.**

(Hearing- Day 11, 2607:3-2607:6, Nov. 10, 2014)

- Poppalardo Testimony

Q You talked a little about NASD Rule 3010(a)(5), and I believe that you said FINRA requires the assignments of each registered person to an appropriately registered principal who shall be responsible for supervising that person's conduct.

A Right.

(Hearing- Day 8, 2008:17-2008:22, Nov. 5, 2014)



- Hasty Testimony

Q I want to direct your attention to two columns, one -- I guess the fourth and fifth column. PI org chart and regulatory supervisor. Do you know what those columns mean or what those terms mean?

A I didn't author this document, and I didn't update it. But typically these particular columns, in a typical scenario, these would be designed to delineate who was responsible for supervising somebody with certain types of licenses.

(Hearing- Day 7, 1748:16-1748:25, Nov. 4, 2014)

266. The purpose of Rule 3010(a)(5) is to protect investors.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Poppalardo testified that one** purpose of Rule 3010(a)(5) is the protection of investors.
- c. Support:
  - Poppalardo Testimony

Q And so you said firms are -- are subject to thousands of regulations. Again, why is that? Why are firms subject to all those regulations?

A It's -- there's a variety of very complex products that are offered, and there's a lot of services that are offered, and there's just a lot of regulation needed around that to make sure that those products are appropriate, they're offered in a way that the investor understands what they're buying, and it's just -- it's a very complex industry.

Q And at the end of the day, the purpose of every single one of those regulations is to protect investors; is that right?

A Correct.

(Hearing- Day 8, 2006:12-2006:25, Nov. 5, 2014)

- Paz Testimony

Q Would you agree with me that regulations are important for broker-dealers?

A Very much so.

Q Why?

A The regulations are put in place to promote fair and efficient markets, to protect investors and to promote capital market.

(Hearing- Day 8, 2102:1-7, Nov. 5, 2014)

267. The “Regulatory Supervisor” column identified a person’s supervisor from a compliance standpoint.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Gardner testified that she assumed that** the “Regulatory Supervisor” column identified a person’s supervisor from a compliance standpoint.
- c. Support:
  - Gardner Testimony

Q The -- looking at the columns that -- that you just discussed with Ms. Atkinson, do you see a column that says "regulatory supervisor"?

A Yes.

Q Do you have any idea what that column means?

A **I don't know the definition of it. I would assume** that it's from a compliance standpoint who the supervisor is.

(Hearing- Day 4, 1162:24-1163:6, Oct. 30, 2014)

268. The “Pi Org Chart Supervisor” designated a person’s “boss” from a Human Resources perspective.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Miller believed that** the “Pi Org Chart Supervisor” column designated a person’s “boss.”
- c. Support:
  - Miller Testimony

Q And when you say it had a column for who their direct supervisor was, what does that mean?

A The person that they reported to day in and day out.

Q Is that the same as that person's boss?

A Yes.

Q Who -- between those two columns, who's the person that would direct the activities of the subordinate?

A It would be the Pi manager.

(Hearing- Day 11, 2590:24-2591:8, Nov. 10, 2014)

269. For the time period relevant to this case, Yancey was always listed as Johnson’s Regulatory Supervisor in PFSI’s supervisory matrix.

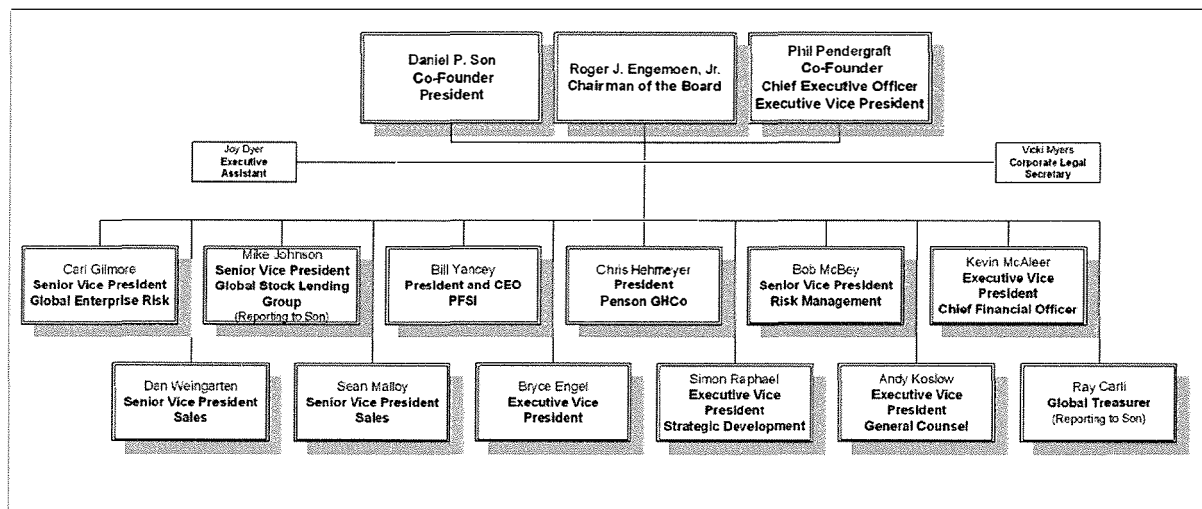
- a. Response: **Dispute**. Division's statement is redundant of Stip. FOF 37 previously stipulated to by all parties. There is no basis for a separate or additional finding of fact.
- b. Counterstatement: Stip. FOF 37 as set forth below.
- c. Support
  - Stip. FOF 37

FOF 37. From 2009 to 2011, the Registered Representative Supervisory Matrix listed Bill Yancey under the column titled Regulatory Supervisor with regard to Michael Johnson.

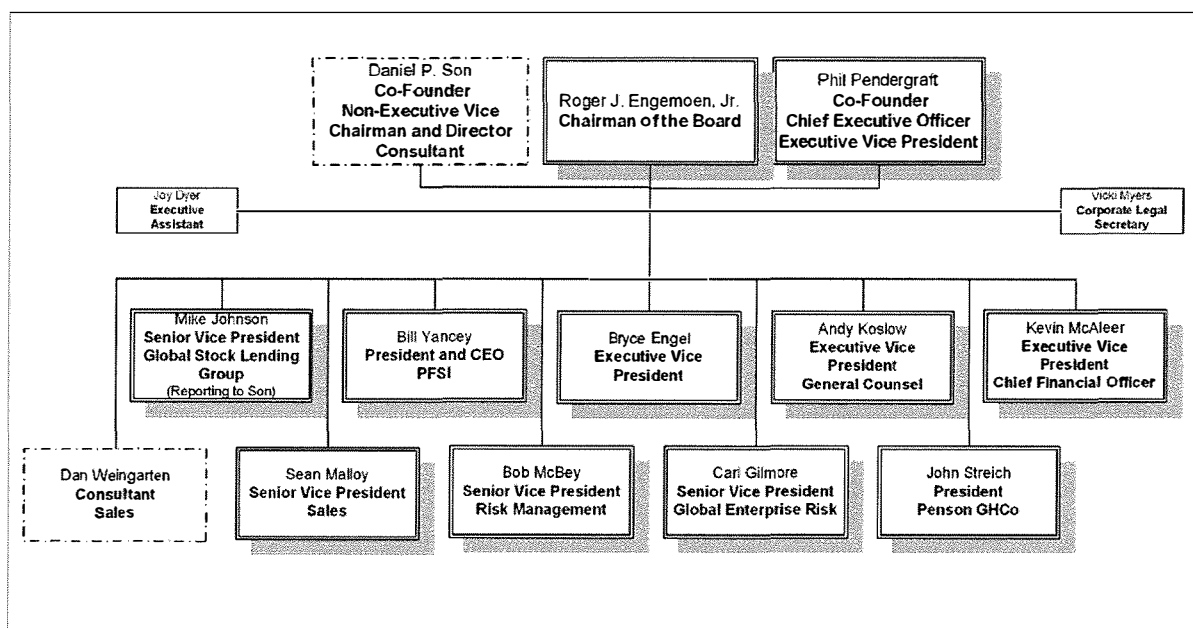
(See Order on Stipulations)

270. From May 2010 forward, Yancey was also listed as Johnson's Pi Org Chart supervisor in PFSI's supervisory matrix.

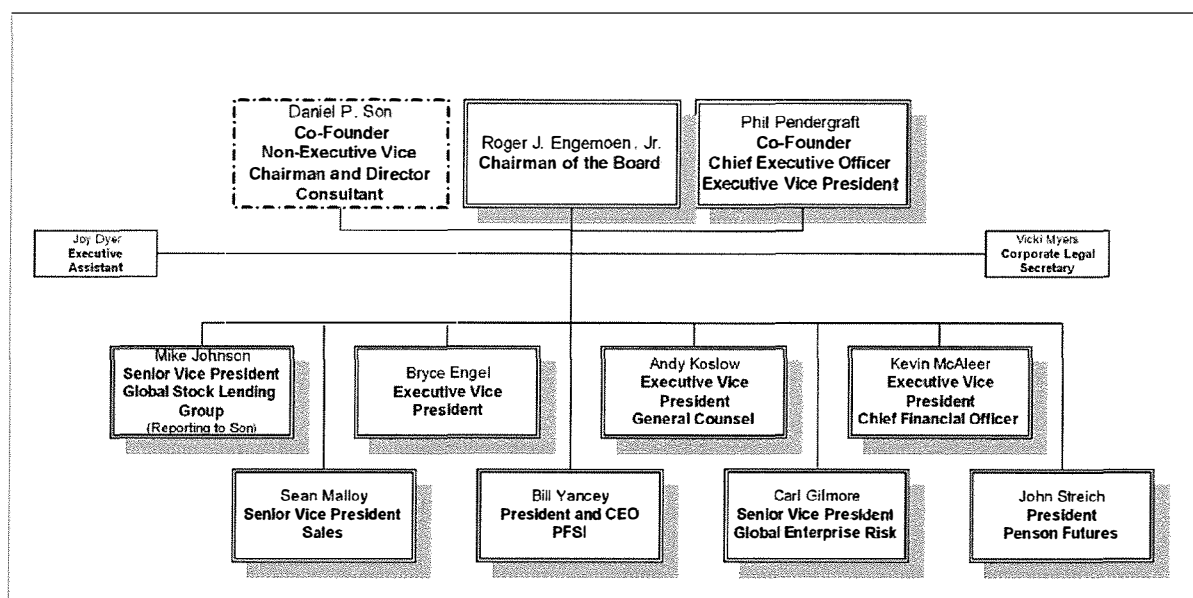
- a. Response: **Dispute** – overbroad. Evidence contravenes Division's statement.
- b. Counterstatement: In the matrices admitted into evidence, circulated beginning in May 2010, Yancey was listed as Johnson's Pi Org Chart supervisor. **The organizational charts for the same period do not reflect Yancey as Johnson's supervisor.**
- c. Support:
  - Ex. 588 (March 2010)



- Ex. 503 (Jan. 2011)



- Ex. 503 (June 2011)



271. PFSI's supervisory matrix did not remain static, but rather was updated frequently.

- Response: *Dispute* – testimony contravenes the Division's statement.
- Counterstatement: Miller testified that she didn't give the supervisory matrix "much thought;" that it "wasn't a big part" of her job; and that she "didn't look at it that often."

c. Support:

- Miller Testimony

Q But just to be clear, you knew that Bill Yancey was not the regulatory supervisor?

A I know that Bill Yancey was not Mike Johnson's regulatory supervisor. I don't know that I gave it any thought with regard to this document. It just wasn't a big part of my job. I didn't look at it that often.

(Hearing-Day 11, 2597:12-18, Nov. 10, 2014)

272. Kim Miller was the compliance department employee charged with maintaining the supervisory matrix.

a. Response: *No dispute.*

273. Miller attempted to make the matrix as accurate as possible, and relied on business unit leaders to advise **them** if the matrix was incorrect or needed revisions. (Miller, exhibits)

a. Response: *Dispute* – accuracy of statement; unclear as stated.

b. Counterstatement: **Miller testified that she would update the supervisory matrix to the best of her ability** to ensure it was accurate, and she relied on the input of the business units when updating the document.

c. Support:

- Miller Testimony

Q And as a general matter, **Ms. Miller, when you would update the supervisory matrix, you would do your best to make sure it was accurate; is that fair?**

A Yes. Obviously, I wanted to be accurate, but I would typically update it because a new employee was hired, and I would add someone or remove someone if they returned. I didn't redo the entire firm each month.

Q That's fair. Let me ask you this: If you had noticed an error on the matrix, you would have tried to correct it, right?

A Yes, of course.

Q **And one of the things you would do when updating it is that you would go to business units and ask for their input on whether certain persons reported -- or where a certain person reported in their business unit; is that fair?**

A Yes.

(Hearing- Day 11, 2609:18-2610:10, Nov. 10, 2014)

- Ex. 277

**To:** Brian [REDACTED] COM]  
**From:** Kimberly Miller  
**Sent:** Wed 4/14/2010 11:23:06 AM  
**Importance:** Normal  
**Subject:** RE: Series 27

OK, I will change it to list you as his Regulatory Supervisor

**From:** Brian Gover  
**Sent:** Wednesday, April 14, 2010 11:20 AM  
**To:** Kimberly Miller; Gary Wiedman  
**Subject:** RE: Series 27

Correct except that Gary continues to report to me.  
Clay continues to report to me as well.  
Thanks

**From:** Kimberly Miller  
**Sent:** Wednesday, April 14, 2010 9:43 AM  
**To:** Brian Gover; Gary Wiedman  
**Subject:** Series 27

As a result of this promotion and since Gary has not passed his 24, the regulatory supervisory matrix now reads as follows. Let me know ASAP if this needs to be changed in any way.

Thank you,

274. If an executive alerted Miller that the supervisory matrix was incorrect, she would correct the document.

a. Response: *No dispute.*

275. At some point, Miller was instructed to **move Johnson from underneath Pendergraft to underneath Yancey, and to add Yancey as Johnson's regulatory supervisor.**

a. Response: *Dispute* – accuracy of statement. The cited testimony does not support the Division's statement.

b. Counterstatement: At some point, Miller was instructed to move **people, including Johnson, from underneath Pendergraft to underneath Yancey.**

c. Support:

- Miller Testimony

Q Do you recall at some point changing this matrix to put Bill's name in as regulatory supervisor for Mike Johnson?

A Yes, sir.

Q Why did you do that?

A **I was directed at some point to move people from underneath Phil onto Bill.**

Q And who directed you to do that?

A I don't recall who directed me to do it.

Q When were you directed to do that?

A It would have been prior to the Ridge conversion, but I don't recall the date.

Q Do you -- Ms. Miller, do you know why you were directed to do that?

A I do not.

Q Do you recall asking any questions at the time you were directed to do that?

A Not that I recall. I don't remember the conversation. I remember doing it. I just -- I don't know what they had going on from a corporate standpoint, that they would have asked me to, but I just -- I didn't question them.

(Hearing- Day 11, 2594:22-2595:18, Nov. 10, 2014)

276. **Miller presumed that Yancey was aware** that she had been instructed to list Yancey as Johnson's regulatory supervisor.

a. Response: **Dispute** – accuracy of statement.

b. Counterstatement: **Miller testified that she assumed** that whoever directed her to move Johnson from Pendergraft to Yancey would have relayed that information to Yancey.

c. Support:

- Miller Testimony

Q By the way, did you -- do you have any recollection of ever telling Mr. Yancey that someone had instructed you to put his name and not Phil Pendergraft's name in the regulatory supervisor --

A I didn't --

Q -- column for Mike Johnson?

A I didn't relay that to Bill. **I assumed that whoever was directing me would have had that conversation.**

(Hearing- Day 11, 2599:2-2599:11, Nov. 10, 2014)

277. Miller provided the matrix to Yancey on more than one occasion.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Miller testified that she thinks** that she provided the matrix to Yancey a couple of times.
- c. Support:
  - Miller Testimony

Q Is this a document that you routinely provided to him?

A **I think I'd given it to him a couple of times. I don't know about routinely.**

(Hearing- Day 11, 2591:25-2592:3, Nov. 10, 2014)

278. In February 2009, Yancey received a copy of the supervisory matrix from Miller that **specifically** updated the Stock Loan supervisory structure. **Yancey was asked to review the supervisory matrix to alert Miller to any additional changes needed.**

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: In February 2009, Miller sent Yancey, and others, a copy of the supervisory matrix that updated the Stock Loan supervisory structure. Yancey was asked to let Miller know if she needed to make additional changes.
- c. Support:
  - Ex. 177 at p.1

To: Bart McCain [REDACTED]@PENSON.COM]; Bill Yancey [REDACTED]@PENSON.COM]; Tom Delaney [REDACTED]@PENSON.COM]  
Cc: Mike Johnson [REDACTED]@PENSON.COM]  
From: Kimberly Miller  
Sent: Thur 2/26/2009 12:43:02 PM  
Importance: Normal  
Subject: Supervisory Structure Update  
Registered Representative Supervisory Matrix.xls



Mike Johnson passed his Series 24 exam this morning. I have updated the supervisory structure to move the stock loan employees from Bill to Mike. A copy of the amended structure is attached. Please let me know if you feel I need to make additional changes before posting.

279. Yancey had a chance to read and review the matrix.

a. Response: *No dispute.*

280. It was Yancey's practice to read e-mails from compliance department employees.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: It was Yancey's practice to read e-mails from compliance department employees **as often as he could.**

c. Support:

- Yancey Testimony

Q And it was your practice, I would assume, to read e-mails that Compliance was sending you and asking for input, right?

A **As often as I could.**

(Hearing- Day 4, 958:23-959:1, Oct. 30, 2014)

281. **Delaney expected that Yancey** would review documents sent to him by the Compliance department for his review.

a. Response: *Dispute* – accuracy of statement.

b. Counterstatement: **Delaney testified that, as a general matter**, he expected that **senior officers** would review documents sent by the Compliance department for their review.

c. Support:

- Delaney Testimony

Q When your Compliance Officer **sends things to senior officers** for their review, did you expect that they would review them?

A **As a general matter, yes. That's always going to be facts and circumstances dependent.**

Q But as a general matter, you would expect that?

A As a general matter.

(Hearing- Day 3, 667:16-667:22, Oct. 29, 2014)

282. Yancey **specifically** responded to Miller and thanked her **for providing the matrix.**

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: Yancey responded “thanks” to an email sent by Miller attaching the matrix.
- c. Support:
  - Ex. 263

**To:** Kimberly Miller[kmiller@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]; Tom Delaney[TDelaney@PENSON.COM]  
**Cc:** Mike Johnson[mjohnson@PENSON.COM]  
**From:** Bill Yancey  
**Sent:** Thur 2/26/2009 12:43:23 PM  
**Importance:** High  
**Subject:** RE: Supervisory Structure Update

Kim

Thanks,

Bill

283. The February 2009 supervisory matrix listed Johnson under Yancey, and listed Yancey as Johnson’s regulatory supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement.

- b. Counterstatement: The supervisory matrix circulated in February 2009 listed Johnson under Yancey, and listed Yancey in the column titled “regulatory supervisor” and Pendergraft in the column titled “Pi Org Chart” supervisor.
- c. Support:
- Ex. 177

[To: Bart McCain [REDACTED]@PENSON.COM]; Bill Yancey [REDACTED]@PENSON.COM]; Tom Delaney [REDACTED]@PENSON.COM]  
 Cc: Mike Johnson [REDACTED]@PENSON.COM]  
 From: Kimberly Miller  
 Sent: Thur 2/26/2009 12:43:02 PM  
 Importance: Normal  
 Subject: Supervisory Structure Update  
Registered Representative Supervisory Matrix.xls

Registered Representatives Supervisory Matrix												
Employee Name	Company	Department	Pi Org Chart	Regulatory Supervisor		License						
Phil Pendergraft	Penson Worldwide	Executives		s7	s24	s27	s4	s15	s53	s83		
<del>Bill Yancey</del>												
Bart McCain	Penson US	Executives	Bill Yancey	Bill Yancey	s7	s24	s4	s8	s10	s27	s55	s65
Thomas Delaney	Penson US	Executives - Global CCO	Bill Yancey	Bill Yancey	s7	s24	s14	s27	s4	s6	s14	s63 s63 s66
John Kenny	Penson US	Executives - Operations	Bill Yancey	Bill Yancey	s7	s24	s27	s4	s53	s63		
Mike Johnson	Penson US	Executives - Securities Lending	Phil Pendergraft	Bill Yancey	s7							
Doug Throckmorton	Penson US	Institutional Client Services	Bill Yancey	Bill Yancey	s7	s24	s6	s53	s63			
Don Weingarten	Penson US	Marketing	Bill Yancey	Bill Yancey	s7	s24	s4	s8	s55	s63		
Jack Boyle	Penson US	Marketing	Keller Reid	Bill Yancey	s7	s4	s55					
Peter Wind	Penson US	Marketing	Phil Pendergraft	Bill Yancey	s7	s4	s53	s66				
Sean Malloy	Penson US	Marketing	Bill Yancey	Bill Yancey	s7							
Amy McCain	Penson US	Relationship Management	Lynal Carey	Bill Yancey	s7	s63						
James Coll	Penson US	Relationship Management	Lynal Carey	Bill Yancey	s7	s55	s24	s4	s63			

284. If Yancey had instructed Miller to move Johnson under Pendergraft, she would have done so. Yancey did not do so.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: **Miller testified that** if Yancey had instructed Miller to move Johnson under Pendergraft, she would have done so. **Miller did not recall Yancey directing her to do so.**
- c. Support:
- Miller Testimony

**Q Now, if Mr. Yancey had responded to you and said, Ms. Miller, there's an error on the document, please move Mike Johnson under Phil Pendergraft, you would have done that?**

**A Yes, I would.**

**Q If Mr. Yancey had responded to you and said, Ms. Miller, there's an error on the document,**

I should not be listed as Mike Johnson's regulatory supervisor, you would have made that change, right?

A Yes.

**Q And you don't recall Mr. Yancey ever saying that to you, do you?**

**A I don't recall that he did, no.**

(Hearing- Day 11, 2614:21-2615:8, Nov. 10, 2014)

285. In May 2010, Yancey **again** received a copy of the supervisory matrix from Miller. Yancey was asked to review the matrix for accuracy.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: In May 2010, **Miller circulated a copy of the supervisory matrix to Yancey and others**. Yancey was asked to review the matrix for accuracy.
- c. Support:
  - Ex. 196 at p.2

**From:** Kimberly Miller  
**Sent:** Wednesday, May 26, 2010 8:58 AM  
**To:** Bill Yancey; Bart McCain; John Kenny; Andy Konchan  
**Subject:** Supervisory Matrix

I have revised the Supervisory Matrix to include Andy Konchan. Please review for accuracy, as we are not always aware of changes made in the Operational areas.

Thank you,



logo-for-signature-2

286. After a PFSI executive **altered** Miller **that she had attached the prior year's supervisory matrix**, Miller re-sent an updated version, again to Yancey.

- a. Response: **Dispute** – accuracy of statement; unclear as stated.
- b. Counterstatement: After a PFSI executive informed Miller that he did not see a certain employee on the matrix and attached a list of changes, Miller circulated a 2010 updated version to a group of executives, including Yancey.

c. Support:

- Ex. 196 at 1

**To:** John Kenny [REDACTED]@PENSON.COM]  
**Cc:** Bill Yancey [REDACTED]@PENSON.COM]; Bart McCain [REDACTED]@PENSON.COM]  
**From:** Kimberly M [REDACTED]  
**Sent:** Wed 5/26/2010 5:49:50 PM  
**Importance:** Normal  
**Subject:** RE: Supervisory Matrix  
Registered Representative Supervisory Matrix 5-2010.pdf

I sent the 09 chart this morning...my apologies. This is the updated chart...

I will compare w/what you provided already to make sure those changes are made...



logo-for-signature-2

**Penson Financial Services, Inc.**  
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P: 214.953.3363 | F: 214.217.5090  
[www.penson.com](http://www.penson.com)

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**From:** John Kenny  
**Sent:** Wednesday, May 26, 2010 5:40 PM  
**To:** Kimberly Miller; Bill Yancey; Bart McCain; Andy Konchan  
**Subject:** RE: Supervisory Matrix

Kim,

I do not see Andy on the attached chart and have attached a list of changes. Please let me know if you have any questions



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**Division's Exhibit**

196

**A.P. No. 3-15873**

287. The May 2010 supervisory matrix listed Johnson under Yancey, and listed Yancey as Johnson's regulatory supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: A supervisory matrix circulated in May 2010 listed Johnson under Yancey, and listed Yancey in the column titled “regulatory supervisor” and Pendergraft in the column titled “Pi Org Chart” supervisor. **An org chart from May 2010 does not show Yancey as Johnson's supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- c. Support:

- Ex. 196 p. 3

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor	Licenses															
						\$4	\$6	\$7	\$8	\$9/10	\$11	\$14	\$15	\$24	\$27	\$31/37	\$39	\$53	\$55	\$63	\$65/\$66
Phil Pendergraft	Penson WW	Dallas, Texas	Executives			\$4	\$7							\$15	\$24	\$27				\$63	
Bill Yancey - President/CEO																					
Thomas Chao	Penson US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey			\$7												\$53	
Cass Smith	Penson US	New York, New York	Customer Development	Lynal Carey	Bill Yancey			\$7									\$39			\$63	
Bart McCain	Penson US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey	\$4		\$7	\$9/10					\$24	\$27			\$55	\$63		
Thomas Delaney	Penson US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey	\$4		\$7	\$8		\$14			\$24	\$27			\$53	\$53	\$66	
John Kenny	Penson US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey	\$4		\$7						\$24	\$27			\$53	\$63		
Mel Johnson	Penson WW	Dallas, Texas	Executives - SVP, Securities Lending	Phil Pendergraft	Bill Yancey			\$7						\$24							
Robert Kirk	Penson US	Dallas, Texas	M&S Business Services - VP	Bill Yancey	Bill Yancey	\$4		\$7						\$24					\$53	\$65	
Amy McLean	Penson US	Dallas, Texas	Relationship Management	Steve Zhang	Bill Yancey			\$7						\$24						\$63	
James Cott	Penson US	Dallas, Texas	Relationship Management	Mark Fawcett	Bill Yancey	\$4		\$7						\$24				\$55	\$63		
Karen Snow	Penson US	Dallas, Texas	Relationship Management	Steve Zhang	Bill Yancey			\$7						\$24				\$53	\$63		
Scott Wood	Penson US	Dallas, Texas	Relationship Management - Director	Lynal Carey	Bill Yancey			\$7						\$24					\$53		
Frank Ellis	Penson US	Dallas, Texas	Relationships - VP	Lynal Carey	Bill Yancey	\$6	\$1													\$63	
Don Weigarten	Penson WW	New York, New York	Sales - SVP	Bill Yancey	Bill Yancey	\$4		\$7	\$8					\$24				\$55	\$63		
Sean Malloy	Penson WW	New York, New York	Sales - SVP	Bill Yancey	Bill Yancey			\$7						\$24						\$63	
Andy Konchan	Penson US	Dallas, Texas	SVP, CIO	Bill Yancey	Bill Yancey			\$7						\$24						\$63	

- Miller Testimony

**Q . . . After Michael Johnson became a PWI employee, to your knowledge was Bill Yancey ever Mike Johnson's Pi org chart supervisor?**

**A No, not that I'm aware of.**

**Q And was he ever his regulatory supervisor?**

**A Not that I'm aware of.**

**Q** So if I showed you 20 or 50 or 100 supervisory matrix documents like this, each with the same entries for Mike Johnson, would it change your view as to who was the Pi org chart and regulatory supervisor for Michael Johnson?

**A** No, sir.

(Hearing – Day 11, 2602:20-2603:6, Nov. 10, 2014).

**Q** But just to be clear, you knew that Bill Yancey was not the regulatory supervisor?

**A I know that Bill Yancey was not Mike Johnson's regulatory supervisor.** I don't know that I gave it any thought with regard to this document. **It just wasn't a big part of my job. I didn't look at it that often.**

(Hearing – Day 11, 2598:12-18, Nov. 10, 2014)

**Q** And then do you see where it says Pi Org Chart, Phil Pendergraft under -- for Mike Johnson?

**A** Yes, sir.

**Q** Is that accurate?

**A** Yes, I believe that to be accurate.

**Q** And do you see where it says Regulatory Supervisor, Bill Yancey?

**A** Yes.

**Q** Is that accurate?

**A I do not believe that's accurate.**

**Q** Why don't you believe that's accurate?

**A** Mr. Pendergraft holds a 24. So the regulatory supervision piece would not have transferred to Bill. It would have remained Phil.

(Hearing – Day 11, 2594:8-21, Nov. 10, 2014)

**Q But how clear are you, in your mind, that it's not correct?**

**A Very clear.** There's a couple of people on here that are -- I know to be Penson Worldwide employees that did report directly to Phil, and that Phil was their direct manager as well as their regulatory supervisor.

(Hearing – Day 11, 2595:19-25, Nov. 10, 2014)

**Q** Do you think, based on your personal experience at Penson, that it's appropriate that Bill Yancey's name be in the Pi Org Chart column?

A No. It still states that Mike is a Penson Worldwide employee, which is where Phil's -- Phil's company, but it's in Worldwide, and so he should be under Phil.

**Q Do you think that the document is wrong when it lists Bill Yancey as the Pi org chart and the regulatory supervisor for Michael Johnson?**

**A In both columns, yes.**

(Hearing – Day 11, 2601:25-2602:7, Nov. 10, 2014).

**Q If you had been asked by Mr. Warner in either of your prior two testimonies about who**

**supervised Mike Johnson, what would you have told him?**

**A He reported to Phil Pendergraft.**

Q And why do you say that?

A Because he reported to Phil Pendergraft. He was a Worldwide employee, and Penson Worldwide employees typically reported to Phil Pendergraft.

Q Is there any other basis that you have for that statement?

A I mean, other than seeing him with Phil, that's, you know -- not really, just knowing that he worked for Phil.

Q And is that still your belief today?

A Yes, sir.

Q Let's talk for a minute about the Stock Loan Department and Mike Johnson and supervision. And let me just ask you: Do you have any -- I'll tell you, this case -- part of this case is about who supervised Mike Johnson.

A Okay.

Q Is there any doubt in your mind about who supervised Mike Johnson?

...

A No, sir.

...

Q Sorry, your answer was?

A No. No, there's no doubt.

**Q Is there any capacity that you can think of in which Phil Pendergraft wasn't Mike Johnson's supervisor?**

**A No, sir.**

(Hearing – Day 11, 2585:9-2586:17, Nov. 10, 2014)

**Q During the time that you were there on the desk, did you see Mike Johnson and Phil Pendergraft interact?**

**A Yes.**

**Q Regularly?**

**A Yes.**

**Q Frequently?**

**A Yes, daily.**

Q What do you mean, daily? This is something you would physically see?

A Yes. He would come into the -- into the space in the mornings.



Q He, Phil?

A Phil Pendergraft, yes, would come into the space in the morning to talk to Mike or Rudy, Brian, the managers in that department.

Q And what kinds of things, if you ever heard, would they -- do you understand they talked about?

A I am -- I'm not sure that I could recall any of the specific conversations.

...

**Q Do you have any sense for the nature of their conversation?**

**A I mean, business, not personal, but I don't know what they discussed.**

**Q Did you ever see Mr. Pendergraft instructing Mike Johnson?**

**A Yes.**

**Q What do you mean by that? Like what did you see or what did you hear?**

**A Him giving him directives, that kind of thing.**

(Hearing – Day 11, 2579:11-2580:22, Nov. 10, 2014)

Q And so we'll look at Mike Johnson in a second, but start, for example, with this fellow Peter Wind. Do you see him?

A Yes, sir.

Q And do you see under Pi or Pi Org Chart and Regulatory Supervisor it says Phil Pendergraft and Bill Yancey?

A Yes, sir.

**Q And is that accurate, in your recollection?**

**A No. I believe that Phil was Peter's primary manager and supervisor.**

Q What about Sean Malloy? It says Bill and Bill.

A I would say the same for Peter and Shawn. They were both Penson Worldwide employees.

Q But are you saying that should be Phil and Phil?

A Yes, sir.

**Q Is that a mistake?**

**A I believe so, yes.**

Q Now, what about under Mike Johnson, do you see that it says Penson U.S.?

A Yes.

Q Did you say earlier you knew him to be a Penson Worldwide employee?

A Yes, he was.

**Q Is that a mistake?**

**A Yes. I would say that that would be an error.**

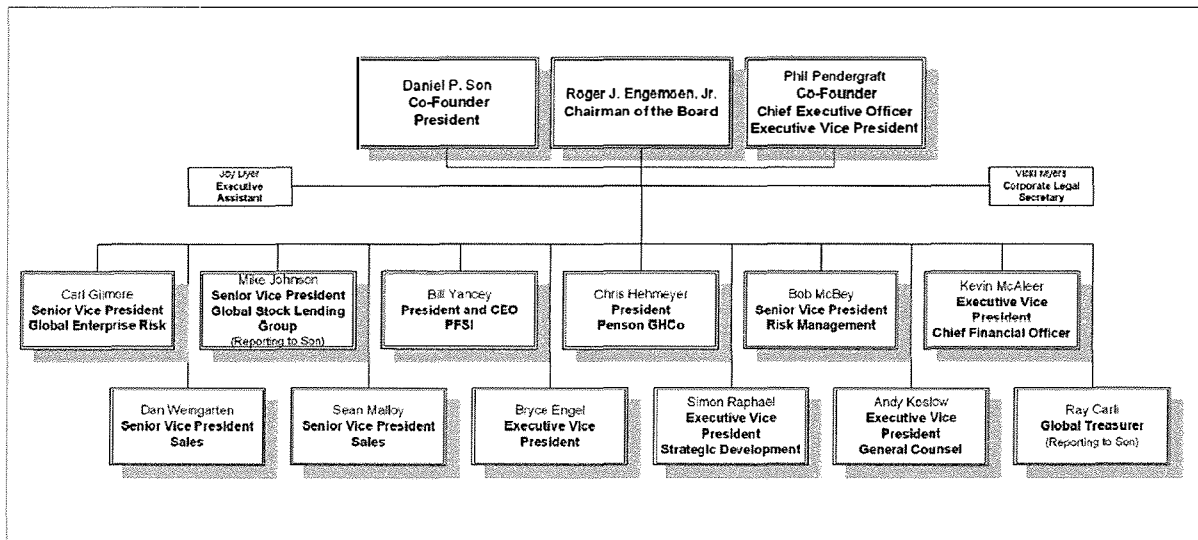
(Hearing – Day 11, 2593:4-2594:7, Nov. 10, 2014)

Q Mr. Pendergraft testified in this trial. Okay? And he testified that he had a role in supervising Mike Johnson, even with respect to PFSI issues, for everything except regulatory and compliance duties. Does that surprise you that he said that?

**A I wouldn't think that that would be accurate.**

(Hearing – Day 11, 2598:6-13, Nov. 10, 2014)

- Ex. 570 (Organizational Chart of May 5, 2010)



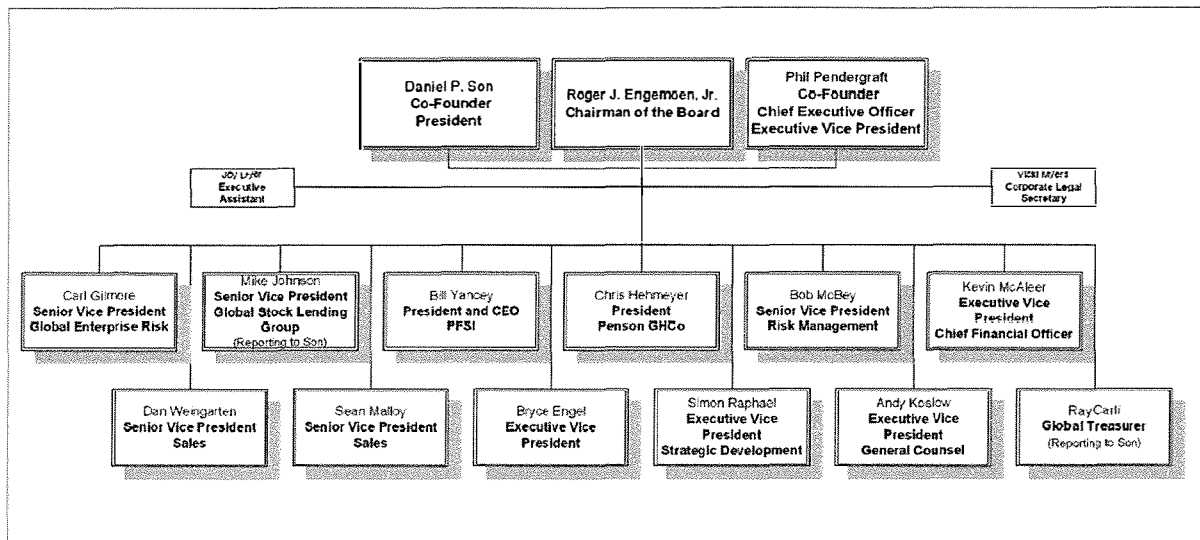
288. The May 2010 supervisory matrix had been updated to amend Johnson's title to Senior Vice President, and his employer to Penson Worldwide. It also continued to designate Yancey as Johnson's regulatory supervisor.

- Response: **Dispute** – accuracy of statement.
- Counterstatement: A supervisory matrix circulated in May 2010 reflected Johnson's title as Senior Vice President and his employer as Penson Worldwide. Yancey was listed in the column titled "regulatory supervisor" and Pendergraft was listed in the column titled "Pi Org Chart" supervisor. **An org chart from May 2010 does not show Yancey as Johnson's supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- Support:

- Ex. 196 p. 3

Employee Name	Company	Location	Department	Pi Org Chart	Regulatory Supervisor	Licenses															
Phil Pendergraft	Penson WV	Dallas, Texas	Executives			\$4	\$6	\$7	\$8	\$9/10	\$11	\$14	\$15	\$24	\$27	\$31/37	\$39	\$53	\$55	\$63	\$65/66
						\$4		\$7						\$15	\$24	\$27				\$63	
<b>Bill Yancey - President/CEO</b>																					
Thomas Chao	Penson US	Dallas, Texas	Client Services		Steve Zhang	Bill Yancey		\$7									\$39			\$63	
Cass Smith	Penson US	New York, New York	Customer Development		Ulysses Carey	Bill Yancey		\$7												\$63	
Burt McCain	Penson US	Dallas, Texas	Executives - EVP, CAO		Bill Yancey	Bill Yancey	\$4	\$7	\$9/10			\$24	\$27					\$53	\$55	\$63	
Thomas DeLaney	Penson US	Dallas, Texas	Executives - SVP, COO		Bill Yancey	Bill Yancey	\$4	\$7	\$8		\$14	\$24	\$27				\$53	\$55	\$63	\$66	
John Kenney	Penson US	Dallas, Texas	Executives - SVP, COO		Bill Yancey	Bill Yancey	\$4	\$7				\$24	\$27				\$53	\$55	\$63		
Mike Johnson	Penson WV	Dallas, Texas	Executives - SVP, Securities Lending		Phil Pendergraft	Bill Yancey		\$7					\$24								
Robert Kirk	Penson US	Dallas, Texas	MS Business Services - VP		Bill Yancey	Bill Yancey	\$4	\$7				\$24						\$63	\$65		
Andy Koslow	Penson US	Dallas, Texas	Relationship Management		Steve Zhang	Bill Yancey		\$7												\$63	
James Cott	Penson US	Dallas, Texas	Relationship Management		Mark Fauver	Bill Yancey	\$4	\$7				\$24						\$55	\$63		
Karen Snow	Penson US	Dallas, Texas	Relationship Management		Steve Zhang	Bill Yancey		\$7				\$24					\$53	\$63			
Scott Wood	Penson US	Dallas, Texas	Relationship Management - Director		Ulysses Carey	Bill Yancey		\$7										\$63			
Patrick Hess	Penson US	Dallas, Texas	Relationships - VP		Ulysses Carey	Bill Yancey	\$6	\$11												\$63	
Dan Wengarten	Penson WV	New York, New York	Sales - SVP		Bill Yancey	Bill Yancey	\$4	\$7	\$8			\$24						\$55	\$63		
Sean Malloy	Penson WV	New York, New York	Sales - SVP		Bill Yancey	Bill Yancey		\$7				\$24						\$63			
Andy Koslow	Penson US	Dallas, Texas	SVP, COO		Bill Yancey	Bill Yancey		\$7				\$24						\$63			

- Ex. 570 p. 17 (Organizational Chart of May 5, 2010)



- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

289. Yancey did not respond to Miller to ask her to make any changes to the supervisory matrix.

- Response: **Dispute** – accuracy of statement; overly broad and does not reflect the accurate scope of the supporting testimony.
- Counterstatement: **Miller testified that she does not recall whether Yancey responded to her email.**
- Support:
  - Yancey Testimony

**Q** Did you reply to Ms. Miller's e-mail and say, there's a mistake, Mike Johnson shouldn't be listed under me?

**A** As I said, I don't remember receiving it, and I don't remember replying to it.

(Hearing- Day 4, 963:15-963:19, Oct. 30, 2014)

- Miller Testimony

**Q** And you don't recall Mr. Yancey ever responding and asking you to make any changes to this matrix, correct?

**A Not by memory, no.**

(Hearing- Day 11, 2618:10-2618:18, Nov. 10, 2014)

290. In August 2010, Joe Ross, a compliance department employee, e-mailed Eric Alaniz a copy of the supervisory matrix. Ross noted that he understood Alaniz discussed the supervisory matrix with Yancey quarterly.

- a. Response: **Dispute** – accuracy of statement; contrary testimony.
- b. Counterstatement: In August 2010, Joe Ross, a compliance department employee, e-mailed Eric Alaniz a copy of the supervisory matrix. Ross noted that he understood Alaniz discussed the supervisory matrix with Yancey quarterly. **Alaniz testified that he did not ever discuss the supervisory matrix with Yancey.**
- c. Support:
  - Alaniz Testimony

Q Exhibit Number 177 [Registered Supervisory Matrix from February 2009].

A I see it.

**Q Have you seen this document before?**

**A Very few times.**

Q Do you know what it is?

A I believe it's a list of individuals with their licenses that they have obtained.

Q Is this something that you used for any purpose?

A I did not use it.

Q Do you know whether it was used in the Compliance department --

A I believe it --

Q -- for any purpose?

A I'm sorry. I believe it was used in conjunction with finding or assigning continuing education – continuing education to individuals based on their licensing.

Q Okay. Did you use that document if you needed to know who someone reported to or who was someone's supervisor?

A No.

**Q Is it a document that you went over with Bill Yancey?**

**A No.**

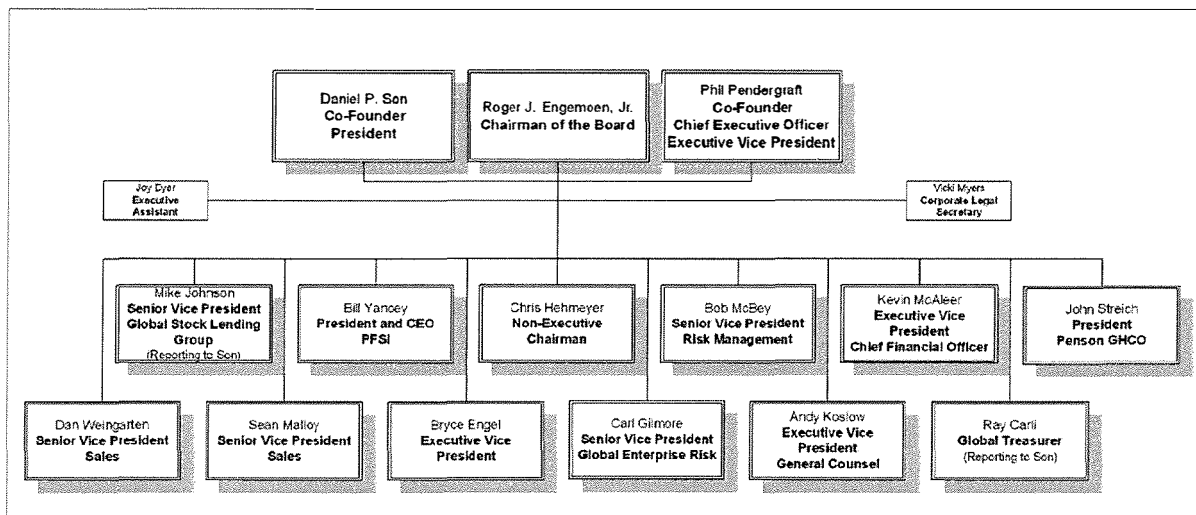
(Hearing – Day 3, 861:22-862:21, Oct. 29, 2014)

291. The August 2010 supervisory matrix lists Johnson under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: A supervisory matrix circulated in August 2010 listed Johnson under Yancey, and Yancey was listed in the columns titled “regulatory supervisor” and “Pi Org Chart” supervisor. **An org chart from August 2010 does not show Yancey as Johnson’s supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- c. Support:
- Ex. 199 p. 2.

Employee Name	Company	Location	Department	Pi Org Chart	Regulatory Supervisor	Registration	S4	S6	S7	S8	S9/10	S11	S14
Pendergraft, Phil	Penson WW	Dallas, Texas	Executives			Series 4, 7, 24, 27, 53, 63	S4		S7				
<b>Bill Yancey - President/CEO</b>													
Chao, Tanning (Thomas)	Penson US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey	Series 7, 63			S7				
Smith, Charles (Cass)	Penson US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey	Series 7, 63			S7				
McBey, Robert	Penson WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey	Series 4, 7, 8, 14, 24, 27, 63	S4		S7	S9/10		S14	
McCan, Bart	Penson US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey	Series 4, 7, 8, 24, 27, 55, 63	S4		S7	S9/10			
Delaney, Thomas	Penson US	Dallas, Texas	Compliance - Chief Compliance Officer	Bill Yancey	Bill Yancey	Series 1, 7, 8, 14, 24, 27, 55, 63	S4		S7	S8		S14	
Kuschall, Andy	Penson US	Dallas, Texas	MIS - Senior Vice President, CIO	Bill Yancey	Bill Yancey	Series 7, 24, 63			S7				
Kenny, John	Penson US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey	Series 4, 7, 24, 27, 53, 63	S4		S7				
Johnson, Michael	Penson WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey	Series 7, 24, Securities Lending Rep			S7				
McLean, Amy	Penson US	Dallas, Texas	Relationship Management	Steve Zhang	Bill Yancey	Series 7, 63			S7				
Cott, James	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	Series 4, 7, 24, 55, 63	S4		S7				
Know, Karen	Penson US	Dallas, Texas	Relationship Management	Steve Zhang	Bill Yancey	Series 7, 24, 53, 63			S7				
Wood, Michael (Scott)	Penson US	Dallas, Texas	Relationship Management - Director	Lynal Carey	Bill Yancey	Series 7, 63			S7				
Tress, Frank	Penson US	Dallas, Texas	Relationships - Vice President	Lynal Carey	Bill Yancey	Series 7, 63			S7				
Weinstein, Daniel	Penson WW	New York, New York	Sales - SVP	Bill Yancey	Bill Yancey	Series 4, 7, 8, 24, 55, 63	S4		S7	S8			
Malloy, Scott	Penson WW	New York, New York	Sales - Senior Vice President	Bill Yancey	Bill Yancey	Series 7, 24, 63			S7				
Lanyon, Michael	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	Series 7			S7				
Lee, Ben	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	Series 4, 7, 55, 63	S4		S7				
Deshi, Milan	Penson US	New York, New York	Relationship Management - Senior VP	Bill Yancey	Bill Yancey	Series 7, 24, 55, 63			S7				

- Ex. 677 p. 62 (Organizational Chart of August 4, 2010)



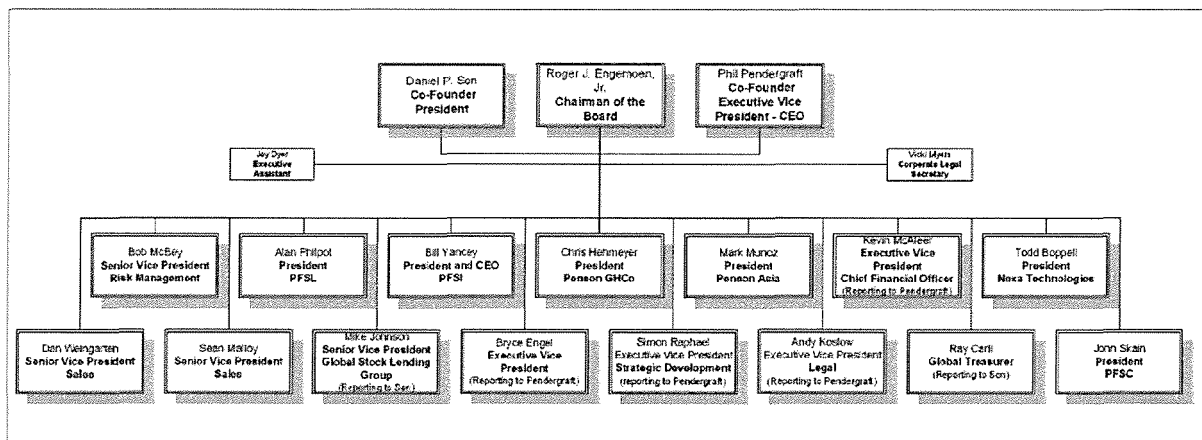
- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

292. In November 2010, Miller e-mailed a copy of the supervisory matrix to Delaney. That supervisory matrix lists Johnson under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: A supervisory matrix circulated in November 2010 listed Johnson under Yancey, and Yancey was listed in the columns titled "regulatory supervisor" and "Pi Org Chart" supervisor. **An org chart from January 2011 does not show Yancey as Johnson's supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- c. Support:
  - Ex. 207 p 3.

Bill Yancey - Pendergraft CEO Person Financial									
Chen, Yanning (Thomas)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey	\$4	\$7	\$8	\$63
Delaney, Thomas	Person US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey	\$4	\$7	\$8	\$53 \$66
McBey, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey	\$4	\$7	\$9-10	\$14 \$24 \$53 \$65
Smith, Eugene (Ewan)	Person US	New York, New York	Customer Development - Manager	Ulysses Carey	Bill Yancey	\$3			\$24 \$27 \$36 \$53 \$63
McCar, Bart	Person US	Dallas, Texas	Executive - EVP, CAO	Bill Yancey	Bill Yancey	\$4	\$7	\$9-10	\$24 \$27 \$36 \$53 \$63
Johnson, Michael	Person WW	Dallas, Texas	Executive - SVP, Securities Lending	Bill Yancey	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Kouchen, Andy	Person US	Dallas, Texas	MS - SVP, CIO	Bill Yancey	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Kerney, John	Person US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Wood, Michael (Scott)	Person US	Dallas, Texas	Relationship Management - Director	Ulysses Carey	Bill Yancey	\$3			\$24 \$27 \$36 \$53 \$63
Curt, James	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Lawson, Michael	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Lee, Ben	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
McLean, Amy	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Ramsey, Alan	Person US	San Francisco, CA	Relationship Management - Relationship Manager	Ulysses Carey	Bill Yancey	\$3		\$9-10	\$24 \$27 \$36 \$53 \$63
Stow, Karen	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Wright, Nelson	Person US	San Francisco, CA	Relationship Management - Relationship Manager	Ulysses Carey	Bill Yancey	\$3			\$24 \$27 \$36 \$53 \$63
Doshi, Milan	Person US	New York, New York	Relationship Management - Senior VP	Bill Yancey	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Hess, Frank	Person US	Dallas, Texas	Relationships - Vice President	Ulysses Carey	Bill Yancey	\$6	\$1		\$24 \$27 \$36 \$53 \$63
Malloy, Sean	Person WW	New York, New York	Sales - Senior Vice President	Bill Yancey	Bill Yancey	\$4	\$7		\$24 \$27 \$36 \$53 \$63
Wengarten, Daniel	Person WW	New York, New York	Sales - Senior Vice President	Bill Yancey	Bill Yancey	\$4	\$7	\$8	\$24 \$27 \$36 \$53 \$63

- Ex. 503 p. 461 (Organizational Chart January 7, 2011).



- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

293. It is important for a broker-dealer to be accurate in its communications with regulators, including documents provided to regulators.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: **Yancey testified that he believes that** it is important for a broker-dealer to be **as accurate as possible** in its communications with regulators.
- c. Support:
  - Yancey Testimony

Q And we can agree that especially for a broker-dealer, communications with regulators are important, correct?

A Yes.

Q And in communications with regulators, it's important to be accurate?

A As possible.

Q Accurate as possible?

A Yes, sir.

**Q And you would personally expect Penson to be accurate in its communications with regulators?**

**A Yes, sir.**

Q You would expect Penson to be honest in its communications with regulators?

A Yes, sir.

(Hearing- Day 3, 881:5-881:19, Oct. 29, 2014)

Q But here we have a letter from Kim Miller in Compliance to FINRA. And I believe we agreed yesterday that **your expectation is that communications from Penson to regulators should be accurate as best as they can, right?**

**A Yes, sir.**

(Hearing- Day 4, 967:24-968:4, Oct. 30, 2014)

- Miller Testimony

Q Let me ask you generally: As a compliance officer, **you knew it was important to be as accurate as possible in your communications with regulators, right?**

A Yes.

Q You would never knowingly provide a regulator false information, right?

A Not intentionally, no.

**Q You did your best to be sure that the documents that you sent were complete and accurate to the best of your knowledge, fair?**

**A Fair.**

(Hearing- Day 11, 2619:7-2619:18, Nov. 10, 2014)

294. Regulators typically requested a copy of the PFSI supervisory matrix.

- a. Response: **Dispute** – accuracy of statement; overly broad.
- b. Counterstatement: Miller testified that on-site examiners typically requested a copy of the PFSI supervisory matrix to assist them with their interview process.
- c. Support:
  - Miller Testimony

Q Now, this is a document that you from time to time would use in responding to regulatory inquiries, is that correct, this matrix?

A Typically, the on-site examiners would ask for a copy of this so that they would -- you know, it would assist them with their interview process.

(Hearing- Day 11, 2596:6-2596:11, Nov. 10, 2014)

295. Miller also sent regulators the PFSI supervisory matrix.

- a. Response: **No dispute**.

296. In September 2010, PFSI sent a regulatory response to FINRA, which was an important regulator of PFSI. In that response, PFSI instructed FINRA to reference the supervisory matrix for a “description of Penson’s supervisory chain identifying each supervisor’s direct reports as well as the individual(s) to which each supervisor reports” for the time period May 2010 through August 2010. In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson’s regulatory supervisory and his “Pi Org Chart” supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: In September 2010, PFSI sent a regulatory response to FINRA, **which Yancey testified was** important regulator of PFSI. In that response, PFSI instructed FINRA to reference the supervisory matrix for a “description of Penson’s supervisory chain identifying each supervisor’s direct reports as well as the individual(s) to which each supervisor reports” for the time period May 2010 through August 2010. In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was listed in the columns titled “regulatory supervisor” and “Pi Org Chart” supervisor. **An org chart from 2010 does not show Yancey as Johnson’s supervisor, and Kim Miller testified that the supervisory matrix was wrong.**



- Ex. 201 at pp. 1, 4, 19

**To:** 'Sheridan, Ryan'[Ryan. [REDACTED]@finra.org]  
**From:** Kimberly Miller  
**Sent:** Wed 9/8/2010 3:20:14 PM  
**Importance:** Normal  
**Subject:** Trading Activity In Various Securities on Various Trade Dates  
FINRA Response - Various Securities.pdf  
Response.zip

Attached is Penson's response to your inquiry dated August 26, 2010.

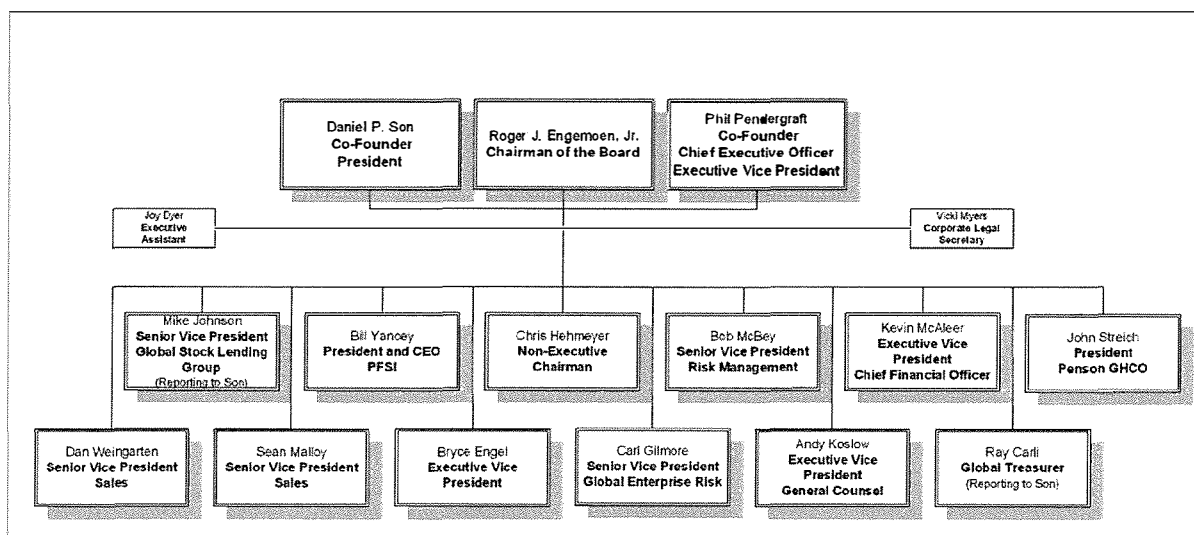
**Not applicable, please see response to Item 1 above.**

11. With respect to the period between May 1, 2010 and August 31, 2010, provide a description of Penson's supervisory chain identifying each supervisor's direct reports as well as the individual(s) to which each supervisor reports. List the name and title of each individual.

***Please refer to the attached Supervisory Matrix.***

[illegible]

- Ex. 677 p. 62 (Organizational Chart of August 4, 2010).



- Yancey Testimony

Q Okay. Exhibit 201 is an e-mail from Kim Miller to Ryan Sheridan at FINRA. Do you see that?

A I see that.

...

Q Do you know who FINRA is?

A Sure.

Q What's FINRA?

A FINRA is a regulatory agency, an SRO.

Q Did they have some regulatory authority over Penson Financial Services?

A Yes, they did.

Q Important regulator?

A Yes.

(Hearing- Day 4, 967:4-967:17, Oct. 30, 2014)

- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

297. Delaney would expect that Kim Miller's submission to FINRA would contain the most accurate, complete and up-to-date information available.

a. Response: *No dispute.*

298. By looking at the September 2010 supervisory matrix, FINRA would conclude that Yancey was Johnson's supervisor.

a. Response: *Dispute* – accuracy of statement. The Division's statement mischaracterizes and does not reflect the scope of the supporting testimony.

- b. Counterstatement: **Witnesses speculated that** when looking at the September 2010 supervisory matrix, FINRA could conclude that Yancey was Johnson's supervisor.
- c. Support:
  - Miller Testimony

Q And so you would agree with me that, just by looking at this document, FINRA would conclude that Bill Yancey was Mike Johnson's supervisor, fair? ...

A I would think that that's what they would think, yes.

(Hearing- Day 11, 2621:25-2622:6, Nov. 10, 2014)

- Hasty Testimony

Q You would agree with me that looking at this, a regulator would believe that Mr. Yancey is Mr. Johnson's supervisor; isn't that correct?

A Yes.

(Hearing- Day 7, 1785:9-12, Nov. 4, 2014)

- Poppalardo Testimony

Q So from at least May 31st, 2010 through November 2010, at least for that period of time, you would agree with me that Penson is telling the regulators that -- that Mr. Yancey is Mr. Johnson's supervisor?

A Yes.

(Hearing- Day 8, 2015:1-2015:6, Nov. 5, 2014)

299. In September 2010, PFSI sent a copy of the supervisory matrix to an examiner at the National Stock Exchange. In that supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

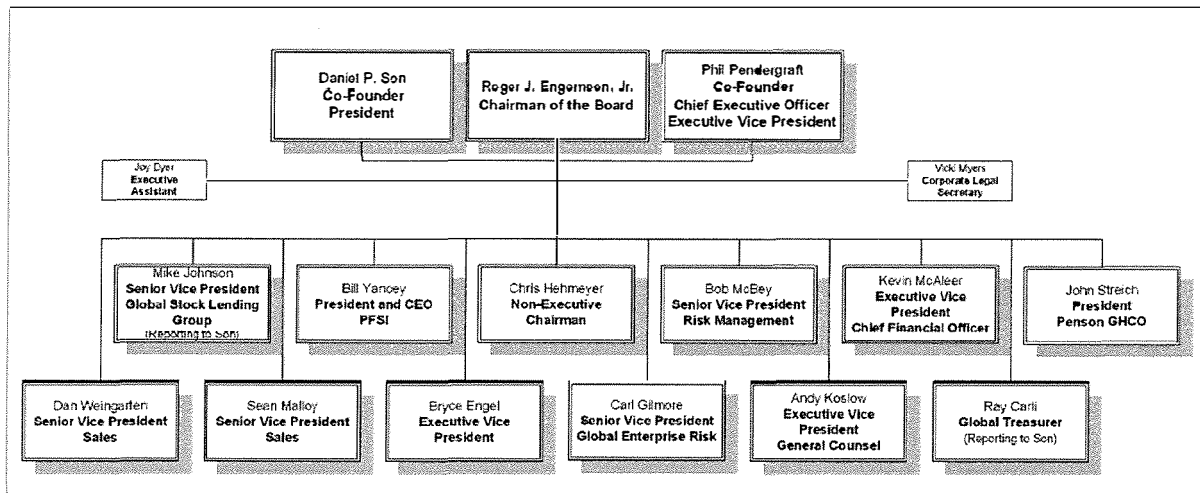
- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: A supervisory matrix sent to the National Stock Exchange in September 2010 listed Johnson under Yancey, and Yancey was listed in the columns titled "regulatory supervisor" and "Pi Org Chart" supervisor. **An org chart from August 2010 does not show Yancey as Johnson's supervisor, and Kim Miller testified that the supervisory matrix was wrong.**

- Ex. 200 pp. 1, 672.

**To:** 'Thomas. [REDACTED]@nsx.com'[Thomas. [REDACTED]@nsx.com]  
**From:** Kimberly [REDACTED]  
**Sent:** Fri 9/3/2010 4:30:24 PM  
**Importance:** Normal  
**Subject:** NSX Correspondence Examination  
National Stock Exchange - ETP Holder Performance Review.zip  
NSX Examination Response FINAL.pdf

Bill Vance: President/COO/Former Financial												
Chao, Taming (Thonia)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Vance	\$4	\$7					\$63
Delaney, Thomas	Person US	Dallas, Texas	Compliance - Staff Chief Compliance Officer	Bill Vance	Bill Vance	\$4	\$8	\$14	\$24	\$27	\$33	\$66
McBrier, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Vance	Bill Vance	\$4	\$8	\$6/16	\$14	\$24		\$63
Smith, Charles (Chas)	Person US	New York, New York	Customer Development - Manager	Liberal Carey	Bill Vance	\$4	\$7				\$39	\$63
McCain, Brett	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Vance	Bill Vance	\$4	\$7	\$6/16		\$24	\$27	\$55
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Vance	Bill Vance		\$7			\$24		
Koonchit, Andy	Person US	Dallas, Texas	MIS - SVP, COO	Bill Vance	Bill Vance		\$7			\$24		\$67
Kenny, John	Person US	Dallas, Texas	Operations - EVP, COO	Bill Vance	Bill Vance	\$4	\$7			\$24	\$27	\$53
Wood, Michael (Scott)	Person US	Dallas, Texas	Relationship Management - Director	Liberal Carey	Bill Vance		\$7					\$63
Carl, James	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Vance	\$4	\$7		\$24			\$55
Lawry, Michael	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Vance		\$7					\$63
Lee, Ben	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Vance	\$4	\$7					\$55
McEwen, Alan	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Vance		\$7					\$63
Ramos, Amy	Person US	San Francisco, CA	Relationship Management - Relationship Manager	Liberal Carey	Bill Vance		\$7	\$6/16		\$24		\$63
Seow, Karen	Person US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Vance		\$7			\$24	\$33	\$63
Whipple, Nelson	Person US	San Francisco, CA	Relationship Management - Relationship Manager	Liberal Carey	Bill Vance		\$7					\$63
Doshi, Milas	Person US	New York, New York	Relationship Management - Senior VP	Bill Vance	Bill Vance		\$7			\$24		\$55
Hess, Frank	Person US	Dallas, Texas	Relationships - Vice President	Liberal Carey	Bill Vance		\$6	\$1				\$63
Mahay, Sean	Person WW	New York, New York	Sales - Senior Vice President	Bill Vance	Bill Vance		\$7			\$24		\$63
Wengertler, David	Person WW	New York, New York	Sales - Senior Vice President	Bill Vance	Bill Vance	\$4	\$7	\$8			\$24	\$55

- Ex. 677 p. 62 (Organizational Chart of August 4, 2010).



- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

300. In October 2010, PFSI sent FINRA a copy of the supervisory matrix. In that supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- a. Response: **Dispute** – accuracy of statement; contrary evidence.
- b. Counterstatement: A supervisory matrix sent to FINRA in October 2010 listed Johnson under Yancey, and Yancey was listed in the columns titled "regulatory supervisor" and "Pi Org Chart" supervisor. **An org chart from November 2010 does not show Yancey as Johnson's supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- c. Support:
  - Ex. 201 pp. 1, 430.

To: 'Sheridan, Ryan'[Ryan. [REDACTED]@finra.org]  
From: Kimberly Miller [REDACTED]  
Sent: Wed 9/8/2010 3:20:14 PM  
Importance: Normal  
Subject: Trading Activity in Various Securities on Various Trade Dates  
FINRA Response - Various Securities.pdf  
[Response.zip](#)

Attached is Penson's response to your inquiry dated August 26, 2010.



logo-for-signature-2

Penson Financial Services, Inc.  
1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201  
P: 214.953.3363 | F: 214.217.5090  
[www.penson.com](http://www.penson.com)

*Building the Best Clearing and Execution Services Firm in the World*





- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).

302. By looking at the November 2010 supervisory matrix, CBOE would conclude that Yancey was Johnson's supervisor.

- a. Response: **Dispute** – accuracy of statement. As written, the Division's statement mischaracterizes and does not reflect the scope of the supporting testimony.
- b. Counterstatement: **Witnesses speculated that** by looking at the supervisory matrix sent in November 2010, CBOE could conclude that Yancey was Johnson's supervisor.
- c. Support:
  - Hasty Testimony

Q Let's look at Exhibit 205. Exhibit 205, the top e-mail, that's from you; is that correct?  
A Yes.  
Q And what is it to?  
A Tanja Samardzija. Sorry, that was a terrible pronunciation.  
Q It's S-A-M-A-R-D-Z-I-J-A. And where does that person work?  
A CBOE.  
Q And what's CBOE?  
A The Chicago Board Options Exchange.  
Q And that's one of Penson's regulators; isn't that right?  
A Yes.  
Q And you send some documents along with your e-mail; is that correct?  
A Yes.  
Q Let look at the document that's labeled Bates number ending 8304, PFSI 1528304. And do you recognize this as the supervisory matrix that we've been discussing?  
A I do.  
Q And this is the document that you sent to the Chicago Board of Options Exchange?  
A I did.  
Q And if you look at the section that is under Mr. Yancey's name --  
A It is cut off on mine.  
Q We can get you a paper copy.  
A That's fine. I just wanted you to know I was going to turn my head. Yes.  
Q So you Mr. Yancey's section?  
A Yes.  
Q Do you see Michael Johnson there?  
A Yes.  
Q And if you read across that row that Mr. Johnson is in, what does it say under Pi org chart?  
A Bill Yancey.



Q And what does it say under regulatory supervisor?  
A Bill Yancey.  
Q Do you see the section that belongs to Mr. Pendergraft?  
A Yes.  
Q And do you see Mr. Johnson anywhere under that section?  
A No.  
Q So you would agree with me that the Chicago Board of Options Exchange receiving this document would understand that Mr. Yancey was Mr. Johnson's supervisor; isn't that true?  
A Yes.

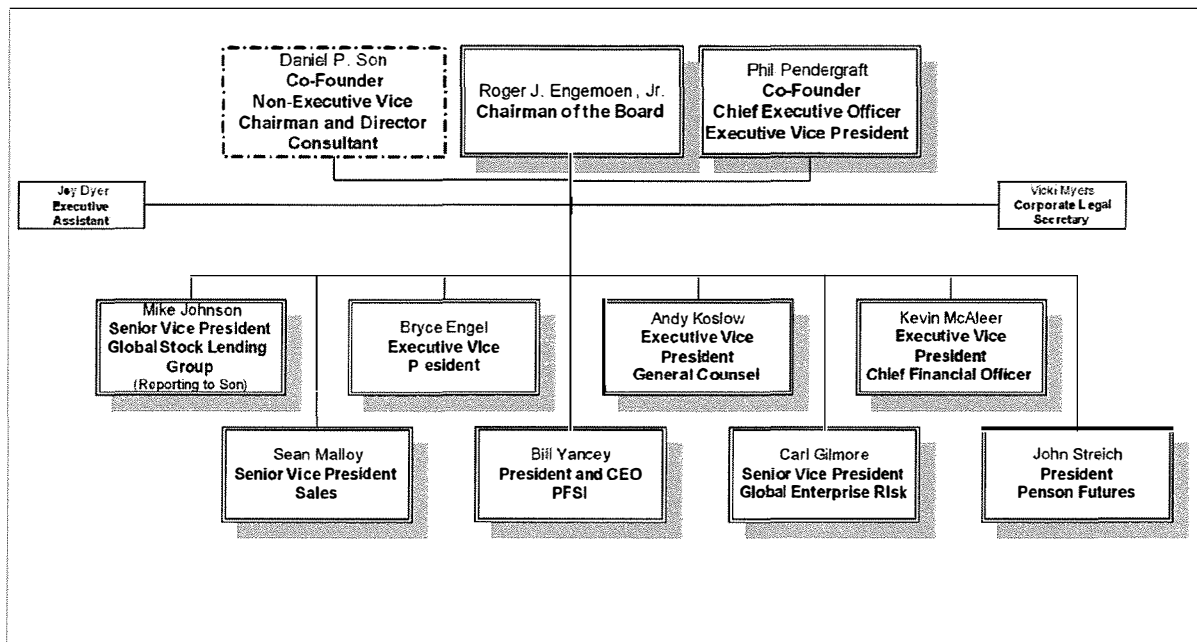
(Hearing- Day 7, 1787:13-1789:14, Nov. 4, 2014)

303. In April 2011, PFSI sent a response to a CBOE inquiry. In that response, PFSI instructed FINRA to reference the supervisory matrix for a description of “regulatory supervisors.” In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson’s regulatory supervisory and his “Pi Org Chart” supervisor. Johnson was not listed under Pendergraft.

- a. Response: *Dispute* – accuracy of statement.
- b. Counterstatement: In April 2011, PFSI sent a response to a CBOE inquiry. In that response, PFSI instructed **CBOE** to reference the supervisory matrix for a description of “regulatory supervisors.” In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was listed in the columns titled “regulatory supervisor” and “Pi Org Chart” supervisor. **An org chart from 2011 does not show Yancey as Johnson’s supervisor, and Kim Miller testified that the supervisory matrix was wrong.**
- c. Support:
  - Ex. 175

Phil Pendergraft - CEO Penson Worldwide									
Yancey, Charles (Bill)	Penson US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft		\$7		
Engel, Bryce	Penson WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft	\$4	\$7	\$24	\$55 \$63
Robinson, Mark	Penson Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft			\$24 \$27	\$63
Anspacher, Richard	Penson GHCO	Dallas, Texas	Finance, SVP	Ben Miller	Phil Pendergraft	\$1		\$40	\$37 \$63
Neshev, Kalin	Penson US	Dallas, Texas	Credit and Market Risk - Market Risk Analyst	Robert Crain	Phil Pendergraft		\$7		
Bill Yancey - President/CEO Penson Financial									
Chao, Yaming (Thomas)	Penson US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey		\$7		\$63
Hasty, Holly	Penson US	Dallas, Texas	Compliance - VP Chief Compliance Officer	Tom Delaney	Tom Delaney	\$4	\$7	\$14	\$24 \$53 \$55 \$63 \$65
Metley, Robert	Penson WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey	\$4	\$7	\$9 \$10	\$14 \$24 \$63 \$65
Smith, Charles (Cass)	Penson US	New York, New York	Customer Development - Manager	Llyndal Carey	Bill Yancey		\$7		\$39 \$63
McGinn, Bert	Penson US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey	\$4	\$7	\$9 \$10	\$24 \$27 \$53 \$63
Johnson, Michael	Penson WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey		\$7		\$24 \$63
Kanehan, Andy	Penson US	Dallas, Texas	MIS - SVP, CIO	Bill Yancey	Bill Yancey		\$7		\$24 \$63
Wood, Michael (Scott)	Penson US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey	\$4	\$7	\$24 \$27	\$53 \$63
Curt, James	Penson US	Dallas, Texas	Relationship Management - Director	Llyndal Carey	Bill Yancey		\$7		\$63
Layton, Michael	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7	\$24	\$53 \$63
Lee, Ben	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey	\$4	\$7		\$53 \$63
McLean, Amy	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey		\$7		\$53 \$63
Ramsey, Alan	Penson US	San Francisco, CA	Relationship Management - Relationship Manager	Llyndal Carey	Bill Yancey		\$7	\$9 \$10	\$24 \$63
Seow, Karen	Penson US	Dallas, Texas	Relationship Management - Relationship Manager	Steve Zhang	Bill Yancey		\$7		\$24 \$53 \$63
Whipple, Nelson	Penson US	San Francisco, CA	Relationship Management - Relationship Manager	Llyndal Carey	Bill Yancey		\$7		\$24 \$63
Doshi, Milan	Penson US	New York, New York	Relationship Management - Senior VP	Bill Yancey	Bill Yancey		\$7		\$24 \$53 \$63
Hess, Frank	Penson US	Dallas, Texas	Relationships - Vice President	Llyndal Carey	Bill Yancey	\$6	\$1		\$24 \$63
Malloy, Sean	Penson WW	New York, New York	Sales - Senior Vice President	Bill Yancey	Bill Yancey		\$7		\$24 \$63

- Ex. 503 p. 47 (Organizational Chart from June 7, 2011).



- Miller Testimony Miller Testimony at 2579:11-2580:22; 2585:9-2586:17; 2593:4-2594:7; 2594:8-21; 2595:19-25; 2598:6-13; 2598:12-18; 2601:25-2602:7; 2602:20-2603:6 (Miller, the author of the matrix, testified it was wrong and that Pendergraft supervised Johnson in every respect).
- Yancey Prop FOF 6 (“Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008”) (and evidence cited therein)

304. After August 2008, Yancey did not exercise any supervision over Johnson or PFSI’s Stock Loan department.

- Response: **Dispute** – accuracy of statement.
- Counterstatement: After August 2008, Yancey did not supervise Johnson because Johnson was fully and reasonably supervised by Pendergraft, and Yancey reasonably followed up on Pendergraft’s supervision.
- Support:
  - Yancey Testimony

Q Okay. And after that time -- just to be sure the record's clear, after August of 2008, as a practical matter, you did not supervise Mike Johnson?

A Correct.

Q And you did not supervise the Stock Lending group at PFSI?

A Because it was fully supervised by Phil Pendergraft.

(Hearing- Day 4, 951:9-951:16, Oct. 30, 2014)

- Pendergraft Testimony (referencing activities listed in Yancey's Prop. FOF 9 related to Stock Loan activities and Pendergraft's supervision of Michael Johnson)

Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws.

A: I believe that.

(Hearing-Day 6, 1537:5-10, Nov. 3, 2014)

305. Yancey asked Johnson not to attend his weekly meetings once Johnson was promoted to Senior Vice President.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Johnson testified that** Yancey asked him not to attend the morning meetings once Johnson was moved to PWI.
- c. Support:
  - Johnson Testimony

Q Were you involved in meetings with Mr. Yancey after that time?

A No. No. I was not in -- I was asked not to attend the morning meetings once I went to Global; however, Bill would stop by my office when he had Stock Loan issues and ask me whatever those questions were.

Q Who is it that asked you not to attend the Monday morning meetings?

A Mr. Yancey.

(Hearing- Day 2, 529:24-530:7, Oct. 28, 2014)

306. Delaney was frustrated that Johnson did not attend the March 31, 2010 meeting with Yancey at which Rule 204 compliance was discussed, because "it was a step that [he] was taking above and beyond [his] role as the Chief Compliance Officer to try and facilitate some supervision discussion around what was happening at that time."

- a. Response: **Dispute** – contrary testimony; incomplete.
- b. Counterstatement: **Delaney recalled that he knew Johnson had been invited to a March 2010 meeting** and that he was **irritated** that Johnson wasn't at the meeting.

c. Support:

- Delaney Testimony

Q I want to go back in time a little bit and I want to ask you a question about Mr. Alaniz's testing. And I don't really want to ask you about Mr. Alaniz's testing; I want to ask you about some of the meetings that occurred after Mr. Alaniz's testing. **And you were discussing with Mr. Breaux the fact that Mr. Johnson didn't come to the March 2010 meeting.** Do you remember that -- that testimony with Mr. Breaux?

A I do.

Q But, in fact, you were concerned that Mr. Johnson wasn't in the meeting; isn't that correct?

A **I remember -- I remember at the time being a little irritated. I knew that he had been invited by Mr. Alaniz to come to the meeting and that he wasn't there. I remember being irritated by it.**

Q Okay. You remember it being remarkable that he wasn't there?

(Hearing- Day 5, 1377:25-1378:17, Oct. 31, 2014)

- Cf. Stip. FOF 96; *see* Exs. 674, 99 (calendar invitation sent to Johnson and several other meeting participants, excluding Yancey), Ex. 633 (March 31, 2010 meeting invitation circulated separately and only to Yancey and Delaney); *see also* Alaniz Test. at 851:2-4 (“Q: So [Yancey’s] invitation didn’t necessarily show who else had been invited to the meeting; is that right?” A: Correct.”); Yancey Test. at 1882:8-1882:11 (“Q: Okay. Well, now, you said it wasn't your invitation. But did you give direction about who should be invited to attend? A: No, ma’am.”).

307. PFSI disclosed to FINRA in March 2011 **that it was violating Rule 204** by not closing out until the afternoon of T+6.

- a. Response: **Dispute** – accuracy of statement. The Division’s statement does not reflect an accurate recitation of the statements in Ex. 89.
- b. Counterstatement: PFSI disclosed to FINRA in March 2011 that it believed it was not industry practice to close out long sales prior to the market open on T+6 and that the firm executed closeouts at approximately 3:00 EST daily.
- c. Support:
  - Ex. 89 at pp. 31-32

### 13. Exception

The Firm was not compliance with Regulation SHO SEC Rule 204 (Close-Out Requirement) and NASD Conduct Rule 3010 (Supervision).

Detail:

#### Response:

*At the time of the examination period, the Firm did not have procedures in place to adhere to the "penalty box" requirement. This gap was discovered in January 2010, independent from this exam. Procedures were developed and put in place in May 2010 to properly identify, and restrict for lending and locating purposes, cases where short sale closeouts were not performed by market open on T+4, borrows were arranged prior to market open on T+4 but did not settle, and long sale closeouts that did not occur on T+6.*

*With regards to the timing of long-sale closeouts, the Firm does not believe it is industry practice to close out long sales prior to the market open on T+6. Not once has the Firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the Firm's borrowing counterparties will not accept a closeout price on a stock loan at the market open. Thus, the Firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the Firm at a competitive disadvantage and ultimately hinder the Firm's ability to cover its customers' delivery obligations.*

308. Even though PFSI disclosed to FINRA in March 2011 that it was violating Rule 204 by not closing out until the afternoon of T+6, and even though that sort of information was information Yancey expected should have been brought to his attention, Yancey did not learn of that practice until long after March 2011.

- a. Response: **Dispute** – accuracy of statement; contains impermissible argument.
- b. Counterstatement: **Yancey testified that he believed** the first time he became aware that Penson saw a conflict between industry practice and the requirements of Rule 204 was long after March 2011.
- c. Support:
  - Yancey Testimony

Q I think what you said is that you did not learn about this at the time in March of 2011; is that right?

A Yes.

Q The first time you learned about it, I think you said was long after that, right?

A I believe so.

...

Q Sure. Let me ask you this. We can agree it was long after March 2011? A Yes.

(Hearing- Day 7, 1923:17-1924:12, Nov. 4, 2014)

Q So the question here reads the same language. You-all are speaking about Exhibit 89. It says: To continue that paragraph, not once has the firm ever borrowed -- ever had a borrower closed out by lending -- by a lending counterparty. Conversely, the firm's borrowing counterparties will not accept a closeout price on a stock loan after market open. Thus, the firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the firm at a competitive disadvantage, and ultimately hinder the firm's ability to cover its customers' delivery obligations. Do you see that?

Answer: Yes.

**Question: Did you understand in March 2011 that Penson saw a conflict between industry practice and the requirements of Rule 204 and chose to follow industry practice?**

**Answer: I really didn't.**

Question: Is this something you would have expected to be brought to your attention?

Answer: Yes.

Did I read that correctly, Mr. Yancey?

A You did.

(Hearing- Day 7, 1925:21-1926:20, Nov. 4, 2014)

309. Pendergraft's primary interactions with Johnson and PFSI Stock Loan were with respect to financing issues.

- a. Response: **Dispute** – accuracy of statement. Conflicting testimony and evidence contradicts the Division's statement.
- b. Counterstatement: Pendergraft actively supervised and frequently communicated with and directed Johnson on a variety of issues.
- c. Support:
  - Stip. FOF 75 ("During the relevant period Phil Pendergraft was an executive vice president of PFSI.")
  - Pendergraft Testimony

Q: . . . At any time, so just throw the date away for a moment, do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose?

A: Well, I'm sure that whenever Mr. Johnson -- *whenever I picked up that as a direct report, whenever I picked up Mr. Johnson as direct report*, I'm highly confident that I talked with Mr. Yancey about it.

...

Q: Did you, from 2008 to 2011, supervise Mr. Johnson in his supervision of PFSI's

**stock lending?**

**A: Well, to the extent that Mr. Johnson provided—well, in certain ways, yes.** The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or to somebody else at the -- in the global organization.

(Hearing- Day 6, 1512:10-21, 1462:1-7, Nov. 3, 2014)

*See also* Yancey Prop. FOF 18 (“Employees at Penson understood Michael Johnson reported to and was supervised by Phil Pendergraft.”) (and evidence cited therein); Yancey Prop FOF 14 (“Phil Pendergraft supervised Mike Johnson”) (and evidence cited therein); Yancey Prop FOF 6 (“Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008) (and evidence cited therein); Yancey Prop FOF 9 (describing Pendergraft’s supervision of Johnson from 2008-2011) (and evidence cited therein); Prop FOF 10 (describing Pendergraft’s supervision of Johnson from 2008-2011) (and evidence cited therein); Yancey Prop FOF 12 (describing Pendergraft’s supervision of Johnson) (and evidence cited therein); Yancey Prop FOF 13 (describing Pendergraft’s supervision of Johnson) (and evidence cited therein).

*See e.g.*, Exs. 502; 506; 515; 517; 521; 526; 527; 528; 529; 248; 549; 550; 557; 563; 565; 573; 590; 591; 605; 607; 627; 636; 638; 664; 666; 667; 668; 670; 678; 684; 688; 707; 709; 710; 711; 726; 7.30; 741; 780; 783; 786; 788; 790; 791; 792; 793; 794; 795; 796; 797; 801; 803; 804; 806; 809; 813; 824 (documents evidencing Pendergraft’s constant supervision of Johnson)

310. In his 12 years working at PFSI and Penson Worldwide, Johnson received only one review, and it was prior to 2008.

- a. Response: ***Dispute*** – accuracy of statement.
- b. Counterstatement: Johnson testified that he thinks he had one review while employed at Penson; he recalls that review was conducted prior to 2008 and given by Yancey, his then-supervisor.
- c. Support:
  - Johnson Testimony

Q When you transitioned and became the head of Global Stock Lending, did you receive any employee reviews?

A I worked at Penson for 12 years, I think, and I had one review.

Q And do you recall approximately when that review was, sir?

A Before 2008.

Q Before 2008?

A Yes, sir.

Q Do you recall who gave you that review?

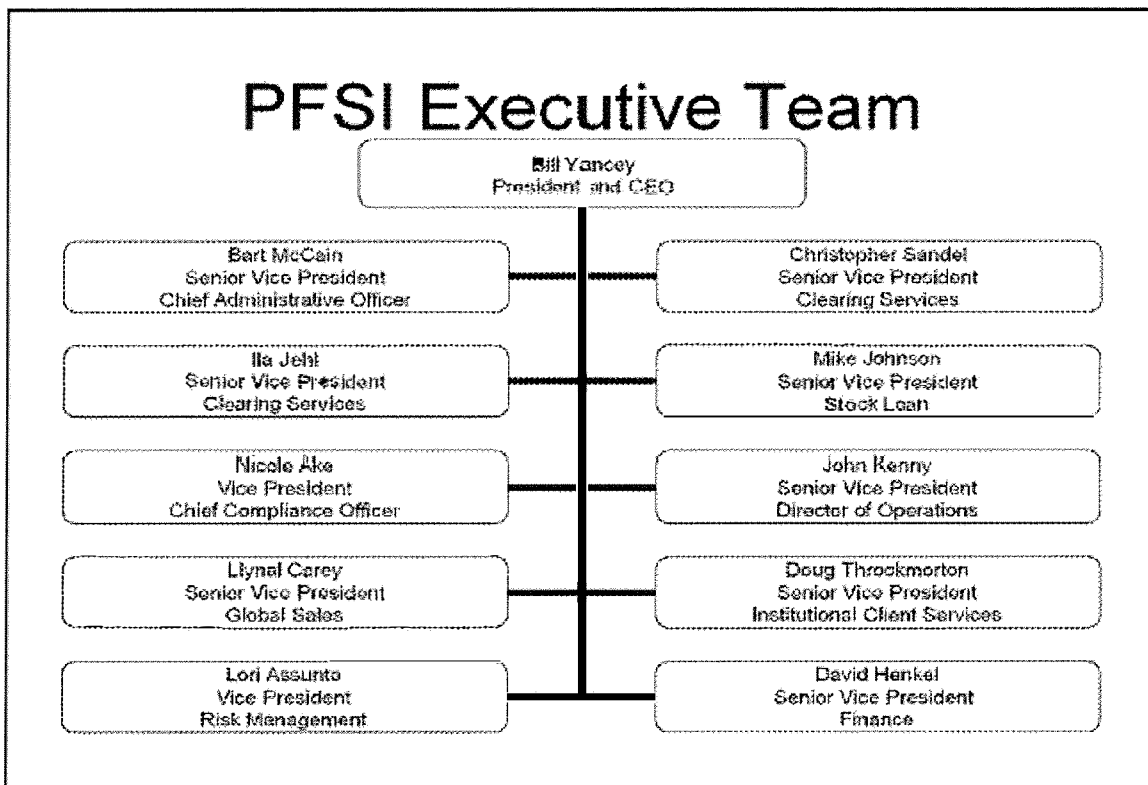
A Uh-huh.

Q Who was it, sir?

**A Mr. Yancey.**

(Hearing- Day 2, 526:16-527:1, Oct. 28, 2014)

- Stip. FOF 118 (“Until Johnson was promoted to PWI Senior Vice President for Global Stock Lending, Yancey was Johnson’s supervisor”)
- Ex. 555 at p. 3 (February 2006 Organizational Chart showing Johnson reporting to Yancey)



311. Johnson was not generally kept in the loop on Penson matters.

- Response: **Dispute** – accuracy of statement.
- Counterstatement: **Johnson testified that he felt** he was not generally kept in the loop on Penson matters.
- Support:
  - Johnson Testimony



Q Okay. Were you generally kept in the loop on decisions that Penson was making?  
 A No.  
 Q Is there any example of that?  
 A Yes.  
 Q Could you describe those, please.  
 A One good example was the -- the merger or acquisition of Broad Ridge. There were probably 80 people involved with that, and I was never told about it as a senior VP in the holding company or a part of it. The day before that was announced, on a Sunday, Dan Son came to my house and told me about it. I was never in the loop with anything related to Penson matters.

(Hearing- Day 2, 527:2-527:14, Oct. 28, 2014)

312. No one at PFSI supervised Johnson or the PFSI Stock Lending department with respect to regulatory or compliance issues.

- a. Response: **Dispute**: Evidence exists that contradicts the Division's statement.
- b. Counterstatement: Pendergraft supervised Johnson in all respects, including regulatory and compliance. Johnson, in turn, supervised the PFSI Stock Lending department.
- c. Support:
  - See Yancey Prop. FOF 10 ("Phil Pendergraft approved Mr. Johnson's activities related to regulatory and compliance issues, including Regulation SHO") (and evidence cited therein).
  - Yancey's Prop. FOF 9, 14, 101, and 102 and supporting evidence therein (evidence that Pendergraft supervised Johnson)
  - Stip. FOF 55 ("Johnson oversaw securities lending activities at PFSI.")
  - See, e.g., De La Sierra Testimony

Q: Mr. DeLaSierra, given your personal observations and the documents we've discussed, in our experience with supervisors, **you would agree that Mr. Pendergraft was supervising Mr. Johnson?**

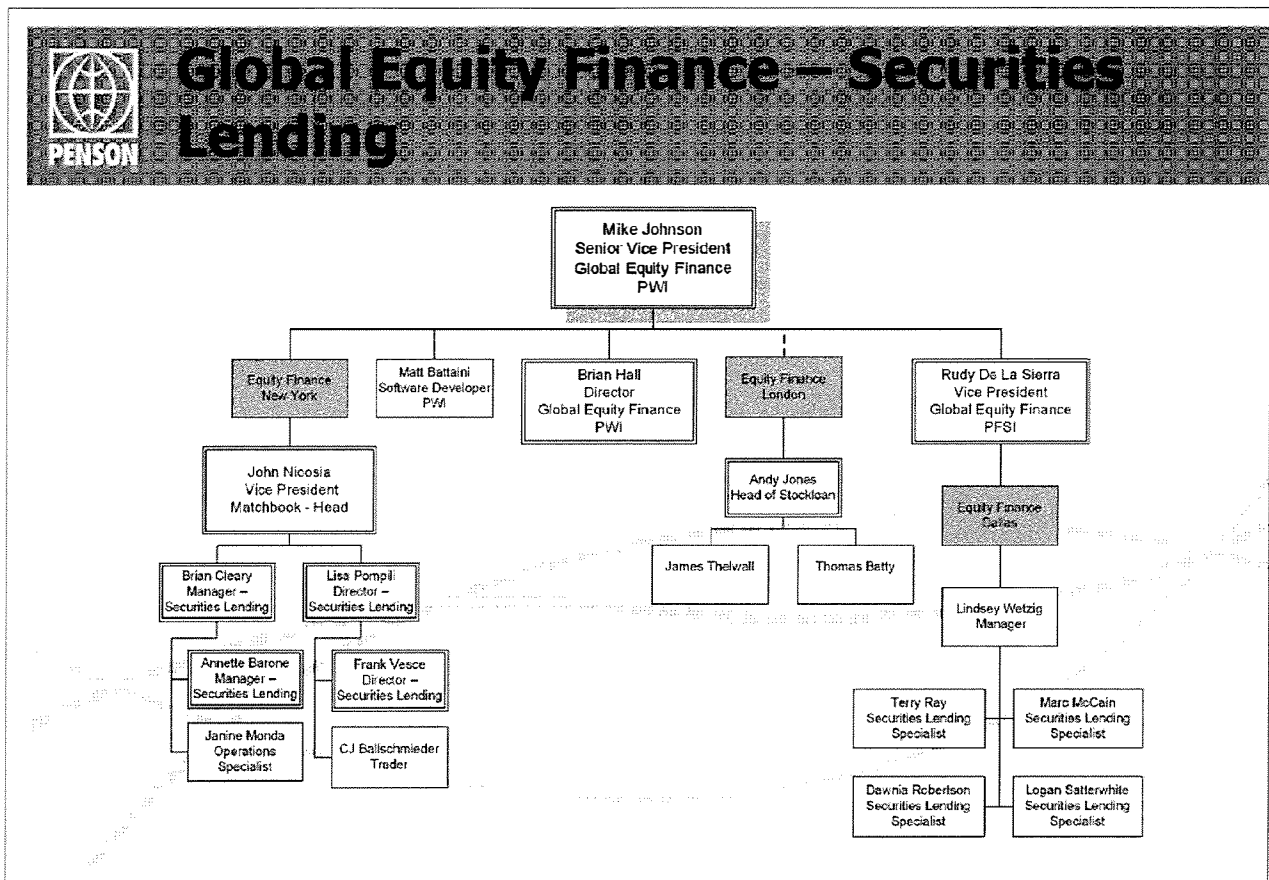
A: Yes.

Q: Okay. And, indeed, that supervision extended to PFSI activities?

A: Yes.

(Hearing-Day 1, 302:22-303:4, Oct. 27, 2014)

- See, e.g., Ex. 571 (2009 Organizational Chart)



313. After Johnson was transitioned to Senior Vice President for Global Securities Lending, PFSI Stock Loan was essentially left alone from an oversight perspective.

- a. Response: **Dispute**. Evidence contradicts the Division’s statement.
- b. Counterstatement: Pendergraft supervised Johnson, who supervised the PFSI Stock Loan department.
- c. Support: See support cited above in response to Division’s Proposed Finding of Fact 312.

314. PFSI Stock Loan was unsupervised; the department had to “run on the fly and make it.”

- a. Response: **Dispute**. Evidence contradicts the Division’s statement.
- b. Counterstatement: Pendergraft supervised Johnson, who supervised the PFSI Stock Lending department.

- c. Support: *See* support cited above in response to Division's Proposed Finding of Fact 312.

315. Prior to the time that Rule 204T was implemented, Mike Johnson requested a compliance person be assigned to the Stock Loan desk to assist with compliance issues. That individual left before Rule 204T was implemented, and was not replaced. Although several compliance personnel sat near the Stock Loan department, they were there because of space issues and did not provide compliance-related guidance to Stock Loan.

- a. Response: **Dispute** – accuracy of statement; misleading statement; contrary testimony.
- b. Counterstatement: Several Compliance personnel sat near the Stock Loan department. The Compliance department gave sufficient guidance to Stock Loan on how to comply with Rule 204.
- c. Support:
- Hasty Testimony

**A I sat in the location where the Stock Loan folks were for a period of time.**

(Hearing-Day 7, 1794:24-25, Nov. 4, 2014)

- Miller Testimony

**Q From a physical proximity standpoint, wherever you officed, was that near the Stock Loan Department?**

**A Yes.** For several years I sat within the Stock Loan Department.

**Q And where was that? What floor was that?**

**A The 19th floor, I believe.**

**Q And how close physically in proximity to the department did you sit?**

**A Well,** we sat on a row -- the four compliance people saw on a row, and they had all the desks on the other side of that row. So they were just on the other side of me. I just -- it was across from me.

**Q So within just a couple of feet?**

**A Yes.**

Hearing-Day 11, 2575:24-2576:13, Nov. 10, 2014)

- De La Sierra Testimony

**A Okay.** So on a -- one side of our room, Mike had his office. He had a sliding window and a door, so that was typically open. I was next to Mike. Next to my left was Brian Hall. We faced Lindsey Wetzig, Terry Ray, Dawnia Robertson, Marc McCain, Logan. Those are the operations. **And then behind them was our two programmers, Matt Battaini and Dave Chen, and Dave faced the three compliance people that were in our group or in our area, I**

should say.

**Q And who were those three compliance people?**

**A Holly Hasty, Kim Miller and Aaron McInerney.**

(Hearing- Day 1, 223:23-224:8, Oct. 27, 2014)

- See also Yancey's response to Division's Prop. FOF 132 and supporting evidence.

316. Yancey currently **worked** in the broker-dealer industry as the managing director of clearing and execution services. **He continues to supervise staff.**

- a. Response: **Dispute** – accuracy of statement; typographical error.
- b. Counterstatement: Yancey currently works in the broker-dealer industry as a managing director of clearing and execution services. **He supervises two salespeople.**
- c. Support:
  - Yancey Testimony

Q All right. Mr. Yancey, do you currently still work in the broker-dealer industry?

A Yes, I do.

Q What's your position? Generally, what do you do in the industry?

A Clearing and execution services.

Q And do you have a title?

A Managing director.

Q Managing director.

**Do you supervise anyone?**

**A Two salespeople.**

(Hearing- Day 4, 985:22-986:7, Oct. 30, 2014)

317. PFSI's overall annual revenue was approximately \$200 million to \$250 million during the relevant time period.

- a. Response: **No dispute.**

318. PFSI Stock Loan's annual revenue was approximately in the range of \$20 million to \$25 million during the relevant time period, or approximately 10% of PFSI's total annual revenues.

- a. Response: **No dispute.**

319. Bonuses were calculated based on three components: performance of Penson Worldwide, the overall corporate entity; performance of PFSI; and **Yancey's** personal goals.

- a. Response: **Dispute** – accuracy of statement. Testimony relates to bonus calculation, generally.
- b. Counterstatement: **Generally**, bonuses were calculated based on three components: performance of Penson Worldwide, the overall corporate entity; performance of PFSI; and personal goals and objectives.
- c. Support:
  - Yancey Testimony

Q Okay. Did you receive any bonuses when you were CEO at Penson Financial Services?  
A At times.  
Q **Do you recall generally how the bonuses were calculated?**  
A **Bonuses were calculated, sort of, in three ways.**  
Q Okay. And what were those ways?  
A Corporate performance, how the whole company did in its entirety, and then operating company performance, and then personal goals and objectives.  
Q So those first two, do I understand right the first is Penson Worldwide's profitability, right?  
A That's right.  
Q And when you say the "operating company," that's PFSI's profitability?  
A Yes.

(Hearing- Day 4, 982:16-983:7, Oct. 30, 2014)

320. From 2008 through 2010, Yancey earned bonuses totaling between approximately \$300,000 to \$1.2 million dollars.

- a. Response: **Dispute** – accuracy of statement.
- b. Counterstatement: **Yancey did not have a clear recollection** of his bonuses earned from 2008 through 2010.
- c. Support:
  - Yancey Testimony

Q In 2008, am I right that your bonus was somewhere greater than 100,000 and less than 500,000? Does that sound right?  
A It's been six years. I think so.  
Q If it would be helpful just to refresh your recollection, Mr. Yancey, if you want to look at your investigative testimony. And this will start on Page 29.  
A Okay.  
Q And I'm going to try to do this logically. I am looking at Line 10: "Question: Did you receive any cash bonuses in 2008?"  
"Answer: Generally" -- excuse me. "I believe so."  
"Question: Generally how much were those bonuses?"

**"Answer: I don't recall."**

"Question: Less than a million dollars?"

"Yes."

"Less than \$500,000?"

"Yes."

"More than \$100,000?"

"I think so."

Does that refresh your recollection that the bonus would have been from -- a range from somewhere more than 100,000 to less than 500,000?

A Probably in that range.

...

Q How about 2009. Is that still the same range, somewhere between 100,000 and 500,000?

**A I just don't have a clear recollection at all.**

Q Let's again, take a look just to see if this helps, Mr. Yancey. If you turn back one page, starting at the bottom of Page 28, Line 24.

**"Question: Can you ballpark your 2009 bonus for me?"**

**"Answer: I can't."**

"Question: More than a million dollars?"

"No."

"More than \$500,000?"

"No."

"More than \$100,000?"

"I think so."

Does that refresh your recollection that it was likely somewhere in the range of 100- to \$500,000?

A Yes, I think probably in that range.

Q Okay. And then again, since you've got the document in front of you, I think I'm doing this in the reverse order of your testimony. I apologize.

On Page 27, starting at Line 3, you were asked -- or excuse me. Your answer is: "2011? No. 2010, yes, I think so."

"Question: So somewhere between 100 and 500 in 2010?"

Your answer was, "Probably between one and two, I would estimate." Does that help refresh your recollection that in 2010, your bonus was between 100 and 200,000?

**A I don't recall, to be very honest. Perhaps.**

(Hearing- Day 4, 983:8-985:18, Oct. 30, 2014)

321. From 2008 through 2011, Delaney earned bonuses totaling approximately \$40,000 dollars.

a. Response: **No dispute.**

322. While Delaney claimed he was no longer acting as a Chief Compliance Officer, his current employer testified that he is currently serving in that position.

a. Response: **Dispute** – accuracy of statement; mischaracterization of testimony.

b. Counterstatement: Delaney stepped down as Chief Compliance Officer at the broker-dealer. **Simpson testified that Delaney is Chief Compliance Officer at the holding company.**

c. Support:

- Delaney Testimony

Q Okay. Were you at one point the Chief Compliance Officer?  
A I was.  
Q When did that change?  
A In June of this past year.  
Q And do you have an understanding of why?  
A I do.  
Q What's that understanding?  
A When -- when I received my Wells letter, that becomes a disclosure issue on your -- on your Form U4. And once I had disclosed it, or in advance of the disclosing of that, I had a conversation with the management and leadership team at First Command. And we agreed that in order to -- which it would not just have been a personal disclosure, but as a Chief Compliance Officer, it also would have been a disclosure for First Command. And we -- we decided that it was best that I step down as the Chief Compliance Officer.  
Q Okay. Who's -- who's your supervisor there at First Command?  
A Hugh Simpson.

(Hearing- Day 5, 1212:20-1213:15, Oct. 31, 2014)

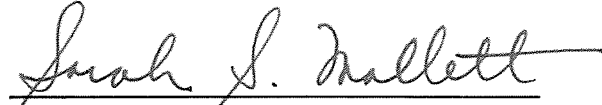
- Simpson Testimony

Q Thank you. In your current position at First Command, as the general counsel, do you lead the legal and compliance group?  
A Yes, I do.  
Q Presently how large is that group?  
A It's 29 persons including myself. It includes the legal team, the compliance team, and also our internal audit team.  
Q Do you know Tom Delaney, sitting here in the courtroom today?  
A Yes, I do.  
Q And how do you know Tom?  
A **Tom serves as the chief compliance officer of our holding company.** He joined us in early 2011 to assume that role, and of course I've known him through the recruiting process and ever since.

(Hearing- Day 6, 1447:9-1447:24, Nov. 3, 2014)

January 20, 2015

Respectfully Submitted,



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